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SECURITIES AND EXCHANGE COMMISSION

This file is maintained pursuant to the Freedom of Information Act (5 U.S.C. 552). It contains a copy of each decision, order, rule or similar action of the Commission, for **December 2014** with respect to which the final votes of individual Members of the Commission are required to be made available for public inspection pursuant to the provisions of that Act.

Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

MARY JO WHITE, CHAIR

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

(1 Document)

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3982 / December 16, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16322

In the Matter of ALEXANDER SWANSON, Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Alexander Swanson ("Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Sections III.2. below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

1 of 1

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Swanson, 49 years old, is a resident of Smithtown, New York. Between 2010 and 2012, Swanson was an associated person of two registered investment advisers.

2. On April 26, 2013, Swanson pled guilty to three counts of wire fraud in violation of Title 18 United States Code, Section 1343 before the United States District Court for the Eastern District of New York, in United States v. Swanson, 13 CR 221 (E.D.N.Y.). On November 14, 2014, Swanson was sentenced to a prison term of 30 months followed by 3 years of supervised release and ordered to forfeit $2.4 million.

3. The counts of the criminal information to which Swanson pled guilty alleged, inter alia, that Swanson falsely promoted himself to investors as an investment manager with a long history of success providing investment advice. Based upon these false and misleading statements, Swanson convinced at least 3 investors to allow him to manage their investment funds, which included retirement funds. These investors entrusted Swanson with their investment funds. Swanson misappropriated portions of the investment funds for his own personal use and benefit.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Swanson's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act, that Respondent be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

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Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

MARY JO WHITE, CHAIR

ELISSE B. WALTER, COMMISSIONER

LUIS A. AGUILAR, COMMISSIONER

TROY A. PAREDES, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

(1 Document)

Commissioner Walter
Not participating
Commissioner Gallagher
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73923 / December 23, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-12805

In the Matter of

Evergreen Investment Management Company, LLC, Evergreen Investment Services, Inc., Evergreen Service Company, LLC and Wachovia Securities, LLC

Respondents.

ORDER DIRECTING DISBURSEMENT

On March 19, 2010, the Commission issued a "Notice of Proposed Plan of Distribution and Opportunity for Comment" ("Notice") in connection with this proceeding (Exchange Act Release No. 61745). No comments were received and, on April 30, 2010, the Secretary of the Commission, pursuant to delegated authority, issued an Order approving the proposed distribution plan (the "Plan") (Exchange Act Rel. No. 62017).

The Plan provides that the Fair Fund consisting of disgorgement, civil penalties, plus any accrued interest be transferred by the Commission to Deutsche Bank Trust Company Americas for distribution by the Fund Administrator to injured investors according to the methodology set forth in the Plan. Pursuant to the Plan, and following the issuance of Orders Directing Disbursement, the Independent Distribution Consultant ("IDC") and the Fund Administrator, in three tranches, distributed $33,187,407.23 to injured investors.[1] There is a significant amount remaining in the Fair Fund after the distribution of those amounts, which is considered the Residual pursuant to the Plan. Paragraph 9.18.1 of the Plan provides that any Residual shall be distributed to those Evergreen funds that incurred aggregate dilution losses of at least $100,000 due to the alleged market timing and shall be allocated amongst these funds based on the

[1] See Exchange Act Release Numbers 63204 (October 28, 2010), 63424 (December 3, 2010), and 63814 (February 1, 2011).

proportion of aggregate dilution losses incurred by each such fund. The Residual funds have been transferred from Deutsche Bank to the Commission.

Accordingly, it is ORDERED that the Commission staff shall disburse the Fair Fund Residual of $6,974,406.04 to be distributed in accordance with the validated payment file prepared pursuant to the Plan.

By the Commission.

Brent J. Fields
Secretary

SECURITIES AND EXCHANGE COMMISSION

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Unless otherwise noted, each of the following individual Members of the Commission voted affirmatively upon each action of the Commission shown in the file:

MARY JO WHITE, CHAIR

LUIS A. AGUILAR, COMMISSIONER

DANIEL M. GALLAGHER, COMMISSIONER

KARA M. STEIN, COMMISSIONER

MICHAEL S. PIWOWAR, COMMISSIONER

(55 Documents)

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73722 / December 3, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16293

In the Matter of LAURIE BEBO, and JOHN BUONO, CPA Respondents.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Laurie Bebo ("Bebo") pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and against John Buono ("Buono") pursuant to Sections 4C and 21C of the Exchange Act and Rule 102(e) of the Commission's Rules of Practice.

II.

After an investigation, the Division of Enforcement alleges that:

A. **Summary**

1. This matter involves disclosure fraud, a fraudulent scheme, lying to auditors, and reporting, record-keeping and internal controls violations by Bebo and Buono, respectively the CEO and CFO of Assisted Living Concepts, Inc. ("ALC"). During the relevant period, ALC was a publicly-traded assisted living and senior residence provider headquartered in Menomonee Falls, Wisconsin.

2. From 2009 through early 2012, Bebo and Buono (collectively, "Respondents") knew, or were reckless in not knowing, that ALC misrepresented in its Forms 10-K and 10-Q that it was in compliance with occupancy and financial covenants included in a lease pursuant to which ALC leased eight of its senior residence facilities. Furthermore, Bebo and Buono undertook an elaborate scheme to hide ALC's lack of compliance with the covenants. Bebo and Buono engaged in the misconduct to avoid defaulting on the lease, which would have required, among other things, ALC to pay the

landlord the amount of rent due on the remaining term of the lease. That amount was between $16 million and $25 million in the relevant time frame.

3. To execute the scheme, Bebo and Buono directed ALC personnel to include in the lease covenant calculations large numbers of fabricated occupants who did not reside at the facilities. Bebo and Buono further directed ALC personnel to record journal entries increasing revenue associated with the fabricated occupancy in the accounts for the leased facilities. ALC made a corresponding journal entry decreasing revenue each period to mask the fraud in ALC's accounting records. To establish the number of fabricated occupants to be included in the covenant calculations, ALC personnel, at Bebo and Buono's direction, reverse-engineered the requisite number of fabricated occupants needed to meet the covenants. Then, shortly after the end of each quarter, ALC provided the facilities' landlord with covenant calculations which included the fabricated occupants and the associated revenue, thus falsely showing that ALC was meeting the covenants.

4. In furtherance of the scheme, Bebo and Buono each quarter created lists identifying the fictitious occupants and their associated lengths of stay at the facilities. These lists contained the following types of non-residents that Bebo and Buono directed ALC to include in the covenant calculations: (1) Bebo's family members and friends; (2) family members (including the seven-year old nephew) of one of Bebo's friends; (3) employees who did not travel to, let alone stay at, the facilities; (4) employees of the leased facilities, who lived nearby and rarely or never stayed at those facilities; (5) employees who had been terminated by ALC or employees who ALC anticipated hiring but who had not yet started; (6) employees who ALC listed as occupants of multiple facilities for the same time period; and (7) other individuals who were neither ALC employees nor residents of the leased facilities.

5. ALC's landlord never agreed to the inclusion of such individuals in the covenant calculations. In addition, ALC's landlord never knew that ALC was including such individuals in the covenant calculations and never knew that ALC would have failed the covenants, by significant amounts, without their inclusion.

6. Nevertheless, in each ALC Form 10-K and 10-Q from the third quarter of 2009 to the fourth quarter of 2011, Bebo and Buono certified the accuracy of ALC's representations that it was in compliance with the lease covenants. Bebo and Buono knew, or were reckless in not knowing, that ALC's representations about the lease covenants were false, misleading, and omitted material information.

B. Respondents

7. Bebo, age 43, is a resident of Hartland, Wisconsin. From November 2006 through May 2012, when she was terminated, Bebo was ALC's President and Chief Executive Officer. From May 2008 through July 2012, Bebo was also a member of ALC's Board of Directors.

8. Buono, age 51, is a resident of Pewaukee, Wisconsin. From October 2006 through July 2013, Buono was ALC's Chief Financial Officer, Senior Vice President, and

Treasurer. From March 1988 through at least September 2013, Buono was a licensed certified public accountant in the state of Wisconsin.

C. Relevant Entities

9. ALC was a Nevada corporation with its principal place of business in Menomonee Falls, Wisconsin. Between November 2006 and July 2013, ALC's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange. During the relevant time period, ALC's primary business was the operation of senior living residences in the United States. In February 2013, ALC agreed to be sold to a private equity firm. In July 2013, when the sale was completed, ALC's stock ceased trading on the New York Stock Exchange.

10. Ventas, Inc. ("Ventas") is a Delaware corporation with its principal place of business in Chicago, Illinois. Ventas's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and trades on the New York Stock Exchange. Ventas is a real estate investment trust ("REIT") with a portfolio of nearly 1,500 senior housing and healthcare properties in the United States and Canada.

D. ALC and the Ventas Lease

11. During the relevant time period, approximately 2008 through mid-2012, ALC operated more than 200 senior living residences in the United States, totaling more than 9,000 units. ALC employed approximately 4,200 people, approximately 200 of whom worked at: (1) ALC's corporate headquarters; or (2) regional or divisional levels, which meant that they worked out of their home or at a regional office. The remainder of ALC's employees worked at the assisted living facilities themselves. For the years 2008 through 2012, ALC's annual revenues ranged from $225 to $234 million.

12. In 2007, Bebo and ALC's Board of Directors were interested in expanding ALC's operations and were offered an opportunity to acquire the operations of a firm which operated eight assisted living facilities that the firm leased from Ventas and were located in Alabama, Florida, Georgia, and South Carolina (the "Ventas facilities"). In order to acquire the operations of the Ventas facilities, ALC was required to enter into a lease with Ventas.

13. As of January 1, 2008, ALC acquired the operations of the Ventas facilities and simultaneously entered into a lease with Ventas to operate those facilities (the "Ventas lease"). These facilities were comprised of approximately 540 total units. The Ventas lease specifically provided that it could only be modified by a writing signed by authorized representatives of both ALC and Ventas and that all "notices, demands, requests, consents, approvals and other communications" under the lease were to be in writing with a copy to Ventas's general counsel.

14. ALC entered the Ventas lease even though it considered various provisions of the lease to be potentially onerous. For instance, the lease contained financial covenants (the "financial covenants"), which required that ALC maintain: (1) a quarterly occupancy of at least 65% at each individual Ventas facility; (2) a trailing twelve-month occupancy of

at least 75% at each individual facility; (3) a trailing twelve-month occupancy of at least 82% for the eight-facility portfolio; (4) a trailing twelve-month coverage ratio of at least 0.8 for each facility; and (5) a trailing twelve-month coverage ratio of at least 1.0 for the entire portfolio. The lease defined "coverage ratio" as each facility's cash flow for an applicable period, divided by ALC's rent payments to Ventas for that facility. The cash flow component of the coverage ratio calculation generally correlated to a facility's occupancy, such that a decline in occupancy would result in an attendant decline in coverage ratio, and vice-versa.

15. The lease's default provisions had significant consequences to ALC. In the event that ALC violated any of the financial covenants, Ventas could: (1) terminate the lease in its entirety; (2) evict ALC from all eight facilities; and (3) require ALC to pay damages equal to the net present value of the unpaid rent for the remaining term of the lease (through March 2015) for the entire portfolio. These damages as of ALC's 2009, 2010, and 2011 fiscal year end would have been \$24.9 million, \$20.9 million and \$16.7 million, respectively. For ALC's 2009, 2010 and 2011 fiscal years, the damage amounts approximated 101%, 81%, and 46% respectively of ALC's income from operations before income taxes, and 56%, 45%, and 31% respectively of ALC's cash flows from operations. Such amounts were material to ALC's financial statements.

16. While Bebo was a strong proponent of entering the Ventas lease, certain ALC officers and directors advocated against entering the lease because of the lease's many disadvantageous provisions, including those referenced above related to the financial covenants. In response to those concerns, Bebo assured the directors that she was confident that ALC could meet the financial covenants.

17. On January 7, 2008, ALC filed a Form 8-K which announced that it had entered the lease with Ventas. The Form 8-K specifically disclosed the financial covenants and the consequences for non-compliance discussed above, and ALC attached the lease as an exhibit to the filing.

E. <u>Less Than a Year After Entering the Ventas Lease, Bebo and Buono Realized that a Financial Covenant Default Was Likely</u>

18. Under the terms of the Ventas lease, ALC was required to demonstrate its compliance with the financial covenants on a quarterly basis. In that regard, ALC was required to provide Ventas within 45 days of the end of a quarter: trailing twelve month income statements for each Ventas facility and for the entire portfolio; quarterly financial statements for each facility, prepared in accordance with Generally Accepted Accounting Principles ("GAAP"); and schedules documenting compliance with the financial covenants. In addition, an ALC executive was required to attest to the completeness and accuracy of such information by signing an officer's certificate and providing it to Ventas along with the information.

19. Bebo, Buono, and various members of ALC's accounting department regularly reviewed and monitored occupancy and coverage ratios at the Ventas facilities to ensure that ALC was meeting the financial covenants and to prepare the required

documentation. Both Bebo and Buono were generally aware of the facilities' occupancy rates and coverage ratios at all times in the relevant time period. In addition, ALC's board required Bebo and Buono to report on ALC's compliance with the covenants in advance of meetings. At each board meeting during the relevant time period (from 2008 through early 2012), Bebo and Buono reported that ALC was in compliance with the covenants.

20. Ventas also paid close attention to ALC's compliance, and considered occupancy and coverage ratio to be key metrics of its properties' performance. For these reasons, Ventas reviewed and scrutinized the financial covenant calculations, quarterly financial statements and other information which accompanied ALC's officer certificates. Ventas personnel also held quarterly conference calls with Bebo and Buono and periodically visited the facilities, during which Ventas representatives asked detailed questions about the financial performance of the Ventas facilities.

21. Shortly after ALC assumed operations of the Ventas facilities, occupancy began declining. In response to concerns raised by the board in the August 2008 meeting regarding ALC's ability to meet the financial covenants, Buono prepared a memo for the November board meeting. That memo, which Bebo reviewed and approved, stated that ALC needed immediate improvement at four of the facilities to meet the financial covenants. By mid-January 2009, Bebo and Buono both knew that ALC would likely default on one or more of the financial covenants in the near future.

F. Bebo and Buono's Scheme to Include ALC Employees and Other Non-Residents in the Ventas Lease Covenant Calculations

22. In an attempt to avoid defaulting on the financial covenants, Bebo initially devised a plan to include ALC employees who stayed overnight at the Ventas facilities as occupants of the properties for purposes of the financial covenant calculations. At certain times, a limited number of ALC corporate, regional and divisional level employees travelled to the Ventas facilities as part of their normal job responsibilities. In an effort to save money, Bebo had directed that some of those employees stay overnight at the facilities in lieu of staying at a hotel.

23. Bebo sought the advice of ALC's general counsel on the permissibility of including employees who stayed at the Ventas facilities in the financial covenant calculations. In response, on January 19, 2009, the general counsel wrote Bebo and Buono an email advising them that for such a practice to be permissible under the Ventas lease, ALC needed to fully disclose the practice to Ventas and obtain Ventas's approval in writing. Nevertheless, ALC never obtained Ventas's written approval to include employees in the covenant calculations or disclosed to Ventas the scheme discussed herein.

24. Beginning in the first quarter of 2009, occupancy at the Ventas facilities had declined to the point where ALC was in violation of certain financial covenants in the Ventas lease. Rather than report the defaults to Ventas, ALC's board of directors, or ALC's shareholders, Bebo directed Buono and his staff to include employees and other non-residents in the financial covenant calculations.

25. Among the non-residents that ALC included in the financial covenant calculations at Bebo and Buono's direction were:

a. ALC employees who never stayed at or traveled to the Ventas facilities;

b. ALC employees who occasionally stayed at the Ventas facilities, but were included in the financial covenant calculations beyond the limited periods that they actually stayed at the facilities;

c. ALC employees who worked at the Ventas facilities, who lived nearby and did not stay overnight at the facilities;

d. Bebo's friends and family members, including her parents and her husband (under different last names than Bebo);

e. Family members, including the seven-year old nephew, of one of Bebo's friends;

f. Former ALC employees who had been terminated by the company;

g. Employees who ALC anticipated hiring but who had not yet started working for the company;

h. ALC employees and other individuals who ALC listed as occupants of multiple Ventas facilities for the same time period; and

i. Other individuals who were neither ALC employees nor residents of the Ventas facilities.

26. At Bebo and Buono's direction, from the third quarter of 2009 to the fourth quarter of 2011, ALC included between 45 and 103 non-residents, such as those persons described in the preceding paragraph, in the Ventas financial covenant calculations. When ALC included such non-residents in the financial covenant calculations, ALC generally included each non-resident in the calculations for every day of the quarter. For each quarter during that time period, ALC would have failed certain occupancy and coverage ratio requirements in the Ventas lease, by significant margins, without the inclusion of such non-residents in the financial covenant calculations.

27. Ventas never agreed to, and was unaware of, ALC's inclusion of such non-residents in the financial covenant calculations. Ventas was also unaware that, without the inclusion of such individuals, ALC would have failed the financial covenant calculations.

G. ALC's Process for Including Employees and Other Non-Residents in the Ventas Lease Covenant Calculations

28. To effectuate the above-described scheme, ALC personnel developed a complex process to determine the required number of employees and other non-residents needed to meet the financial covenants. The process involved the following steps, all of which were performed as directed by Buono, with Bebo's approval, or performed by Bebo and Buono themselves.

29. First, after the end of each month in a given quarter, ALC accounting personnel determined the amount by which ALC would fail any of the financial covenants. Then, ALC personnel reverse-engineered the number of non-residents necessary for the month to at least meet, if not exceed, the financial covenants. In doing so, ALC presumed that each non-resident would be included in the financial covenant calculations for every day of the month.

30. ALC then prepared monthly journal entries which recorded revenue associated with the non-residents' inclusion in the financial covenant calculations. These journal entries: (1) increased revenue for the individual Ventas facilities; and (2) decreased revenue in the same amount in a corporate revenue account. Either Buono or Bebo initialed the entry before it was recorded in ALC's books and records.

31. After the revenue for the last month of a given quarter was recorded, ALC accounting personnel performed the financial covenant calculations, including the above-referenced non-resident occupancy and revenue adjustments, to ensure that all the financial covenants had been met.

32. Following the end of each quarter, after ALC calculated the number of non-residents to include in the financial covenant calculations, Bebo personally determined the identities of the non-residents that ALC would include in the financial covenant calculations, and provided a list of such individuals to Buono and ALC accounting personnel, who then provided the list to ALC's auditors.

33. Each quarter, beginning with the first quarter of 2009, ALC prepared and sent to Ventas: (1) the quarterly financial covenant calculations which included the above-referenced non-residents and attendant revenue, and thus showed ALC meeting or exceeding the financial covenants; (2) financial statements for the Ventas facilities which incorporated the revenue associated with the non-residents; and (3) an officer's certificate signed by Buono in which he attested that the information provided was complete and accurate and that the financial statements for the Ventas facilities complied with GAAP. The quarterly materials ALC sent to Ventas did not reference the inclusion of non-residents in the covenant calculations.

H. Bebo and Buono Actively Sought to Prevent Ventas from Learning About the Inclusion of Non-Residents in the Covenant Calculations

34. At Buono's and Bebo's direction, ALC personnel did not provide Ventas with any information indicating that ALC had included non-residents in the financial

covenant calculations. As a result, Ventas was unaware that ALC was including non-residents in the financial covenant calculations. Moreover, rather than disclose the inclusion of the non-residents in the financial covenant calculations, Bebo and Buono employed a variety of measures to hide the practice from Ventas.

35. For instance, on a number of occasions, Bebo or Buono provided Ventas with fictitious explanations for quarterly occupancy or coverage ratio changes at the Ventas facilities in lieu of providing the only possible truthful explanation, which was an increase or decrease in the number of non-residents being included in the financial covenant calculations.

36. On at least two occasions, Buono changed the number of non-residents being included in the financial covenant calculations to avoid arousing suspicion on the part of Ventas. Buono did so to make it appear that ALC was exceeding the financial covenants, as opposed to just meeting them, or to make changes in the number of non-residents so that changes in occupancy and coverage ratio ALC reported to Ventas appeared less dramatic and more realistic.

37. On another occasion, ALC had to revise the number of non-residents included in the financial covenant calculations, because it had initially reported occupancy to Ventas in excess of 100%. At Buono's direction, ALC told Ventas that the initial reporting was due to an accounting error and did not disclose that the revision related to the number of non-residents included in the financial covenant calculations.

38. In summer 2011, ALC was exploring a sale of the company, and was preparing due diligence materials to be reviewed by potential buyers, one of which was Ventas. Bebo directed ALC's investment bankers not to provide Ventas with actual occupancy figures at the Ventas facilities but permitted the investment bankers to provide such information to other interested buyers.

39. Moreover, Bebo attempted to thwart Ventas's ability to determine actual occupancy during Ventas's periodic inspections of the Ventas facilities. To that end, Bebo: (a) restricted Ventas from visiting certain facilities at particular times, and (b) directed that resident name tags be removed from their doors during Ventas's inspections, such that Ventas could not manually count the number of occupied rooms.

40. In March 2012, Bebo tried to convince ALC's board not to disclose the inclusion of non-residents in the Ventas financial covenant calculations to the remaining potential bidders interested in purchasing ALC.

I. <u>ALC's False and Misleading Disclosures in its Commission Filings</u>

41. ALC's Forms 10-K for the years ending December 31, 2009, 2010 and 2011 (which Bebo and Buono signed) and its Forms 10-Q for the first three quarters of those years (which Buono signed) contained the representation that ALC was in compliance with the financial covenants in the Ventas lease.

42. Moreover, ALC's Form 10-K for the year ending December 31, 2011 and its Forms 10-Q for the second and third quarter of that year contained the following representation: "ALC does not believe that there is a reasonably likely degree of risk of breach of the [Ventas financial] covenants."

43. As a result of the improper inclusion of employees and other non-residents in the Ventas financial covenant calculations, and the fact that ALC would have failed the covenants without the inclusion of such persons, the above-described statements in ALC's Forms 10-K and 10-Q were false, misleading, and omitted material information.

44. In connection with each of the above-referenced Forms 10-K and 10-Q, Bebo and Buono signed certifications which certified that: (1) ALC's filings did not contain any material misstatements or omissions; (2) ALC's filings fairly presented in all material respects ALC's financial condition, results of operation and cash flows; and (3) they had designed or caused to be designed such internal controls to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with GAAP.

45. Given the inclusion of employees and other non-residents in the Ventas financial covenant calculations, Bebo and Buono either knew, or were reckless in not knowing, that ALC's above-referenced Forms 10-K and 10-Q and the above-referenced certifications were false, misleading, and omitted material information.

46. In each of the above-referenced Forms 10-K and 10-Q, ALC additionally failed to disclose a loss contingency associated with ALC's violation of the Ventas financial covenants and the impact of such contingency on ALC's operations and financial statements. Such a disclosure was required under GAAP. Accounting Standards Codification ("ASC") 450-20-50-3. Buono either knew, or was reckless in not knowing, that ALC's filings improperly failed to disclose such a loss contingency.

J. <u>Bebo and Buono Made False Representations to ALC's Auditors</u>

47. In connection with the audits of ALC's financial statements for the years ending December 31, 2009, 2010 and 2011, and in connection with the reviews of ALC's quarterly financial statements for the first three quarters of those years, Bebo and Buono signed a representation letter addressed to ALC's auditors in which they falsely represented that ALC had "complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of a noncompliance." Bebo, Buono, and ALC's auditors understood this representation to attest to compliance with the Ventas financial covenants.

48. Given the inclusion of employees and other non-residents in the Ventas financial covenant calculations, Bebo and Buono either knew, or were reckless in not knowing, that their above-described representation to ALC's auditors was false, misleading, and omitted material information.

49. In connection with the same audits and reviews, ALC, at Bebo's and Buono's direction, provided the auditors with the above-referenced lists, created by Bebo

and Buono, identifying fictitious occupants at the Ventas facilities and their associated lengths of stay at the facilities.

50. Moreover, in connection with the audit of ALC's financial statements for the year ending December 31, 2011, Bebo and Buono signed a representation letter addressed to ALC's auditors that represented that Bebo and Buono had no knowledge of any allegations of fraud or suspected fraud by any ALC employee. Bebo and Buono either knew, or were reckless in not knowing, that such statement was false and misleading, given that in approximately November 2011, an ALC employee confronted Bebo and Buono with concerns that the inclusion of employees in the Ventas financial covenant calculations was fraudulent.

K. The Scheme Unravels

51. In April 2012, Ventas filed a lawsuit against ALC unrelated to the financial covenants. At the time, Ventas was unaware that ALC had been including employees and other non-residents in the financial covenant calculations.

52. In connection with related settlement negotiations with Ventas, Bebo tried to convince ALC's board not to disclose to Ventas ALC's inclusion of employees and other nonresidents in the Ventas financial covenant calculations. Bebo actively lobbied against a director's demand that ALC include in any settlement proposal specific language whereby Ventas would release claims arising from ALC's inclusion of employees in the financial covenant calculations.

53. Bebo's efforts were unsuccessful, and ALC sought a release from Ventas expressly relating to the inclusion of employees in the financial covenant calculations and the quarterly certifications ALC sent to Ventas. After receiving ALC's request for the release, Ventas moved to amend its complaint against ALC to include allegations relating to ALC's inclusion of employees in the covenant calculations.

54. In June 2012, ALC and Ventas settled the lawsuit, which included a release of all claims related to the Ventas lease. As part of the settlement, ALC purchased the Ventas facilities and certain other facilities from Ventas for an amount far greater than the appraised value of the facilities. ALC paid approximately $100 million to settle the litigation and purchase the facilities, even though independent third party appraisals only valued the purchased facilities at $62.8 million. Thus, in its financial statements for the second quarter of 2012, ALC included as an expense $37.2 million for "lease termination and settlement" and also wrote off the entirety of the remaining lease intangible assets associated with the Ventas facilities, which were approximately $8.96 million.

L. Violations

55. As a result of the conduct described above, Bebo violated and Buono willfully violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of any security involving: a) the use of any device, scheme, or artifice to defraud; b) the making of material misrepresentations or omissions; and c) any act, practice, or course of business

which operates or would operate as a fraud or deceit upon any person. Also, by engaging in the conduct described above, Bebo caused and Buono willfully aided and abetted and caused ALC's violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder.

56. As a result of the conduct described above, Bebo caused and Buono willfully aided and abetted and caused ALC's violations of Section 13(a) of the Exchange Act and Rules 13a-1 and 13a-13 thereunder, which require issuers with securities registered under Section 12 of the Exchange Act to file factually accurate annual and quarterly reports. Also, Bebo caused and Buono willfully aided and abetted and caused ALC's violations of Rule 12b-20 of the Exchange Act, which requires the addition to such reports any further material information necessary to make the required reports not misleading.

57. As a result of the conduct described above, Bebo violated and Buono willfully violated Exchange Act Rule 13a-14, which requires an issuer's principal executive officer and principal financial officer to certify each periodic report containing financial statements filed by the issuer pursuant to Section 13(a) of the Exchange Act.

58. As a result of the conduct described above, Bebo violated and Buono willfully violated Exchange Act Section 13(b)(5), which prohibits any person from knowingly circumventing or knowingly failing to implement a system of internal accounting controls or knowingly falsifying any book, record or account subject to Exchange Act Section 13(b)(2). Also, Bebo violated and Buono willfully violated Exchange Act Rule 13b2-1, which prohibits any person from, directly or indirectly, falsifying or causing to be falsified, any book, record or account subject to Exchange Act Section 13(b)(2).

59. As a result of the conduct described above, Bebo violated and Buono willfully violated Exchange Act Rule 13b2-2, which prohibits any director or officer of an issuer from, directly or indirectly from: (a) making or causing to be made a materially false or misleading statement; or (b) omitting or causing another person to omit to state a material fact necessary in order to make statements made, in light of the circumstances under which such statements were made, not misleading, to an accountant in connection with financial statement audits, reviews, or examinations or the preparation or filing of any document or report required to be filed with the Commission.

60. By engaging in the conduct described above, Bebo caused and Buono willfully aided and abetted and caused ALC's violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act, which requires an issuer of securities registered under Section 12 of the Exchange Act to make and keep accurate books, records, and accounts, and to devise and maintain a sufficient system of internal accounting controls.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. Whether, pursuant to Section 21C of the Exchange Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 10(b), 13(a), 13(b)(2)(A), 13(b)(2)(B) and 13(b)(5) of the Exchange Act and Rules 10b-5, 12b-20, 13a-1, 13a-13, 13a-14, 13b2-1 and 13b2-2 thereunder;

C. What, if any, remedial action is appropriate in the public interest against Respondents, including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

D. Whether, pursuant to Section 21C(f) of the Exchange Act, Respondents should be prohibited, conditionally or unconditionally, and permanently or for such period of time as the Commission shall determine, from acting as an officer or director of any issuer that has a class of securities registered pursuant to Section 12 of the Exchange Act, or that is required to file reports pursuant to Section 15(d) of the Exchange Act; and

E. Whether, pursuant to Section 4C of the Exchange Act and Section 102(e) of the Commission's Rules of Practice, Buono should be denied, temporarily or permanently, the privilege of appearing or practicing before the Commission as an accountant.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If a Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him or her upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the

Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents as provided for in the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Commissioner Stein
Not participating
Commissioner Piwowar
Disapproved

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73724 / December 3, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3974 / December 3, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16294

In the Matter of

PHILLIP DENNIS MURPHY,

Respondent.

ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Phillip Dennis Murphy ("Murphy" or "Respondent").

II.

After an investigation, the Division of Enforcement alleges:

A. RESPONDENT

1. From approximately June 1998 until approximately September 2002, Murphy was employed as a dual officer of Banc of America Securities LLC ("BAS") and Bank of America, N.A. ("BANA") (collectively referred to as "BofA"). BAS, now known as Merrill Lynch, Pierce, Fenner & Smith Incorporated, successor by merger, was a Delaware limited liability corporation with its principal place of business in New York, New York, and was registered with the Commission as a broker-dealer pursuant to Section 15(b) of the Exchange Act

and as an investment adviser pursuant to Section 203(c) of the Advisers Act.[1] BANA is a federally-chartered commercial bank with its principal place of business in Charlotte, North Carolina. During the relevant time period, Murphy worked in BofA's Municipal Reinvestment and Risk Management Group as a Managing Director of Municipal Derivative Products and as a marketer of investment agreements and other municipal finance contracts. For a portion of the time in which he engaged in the conduct underlying the indictment described below, Murphy was a registered representative associated with the dual registrant, BAS. Murphy, age 56, is a resident of Columbia, New Jersey.

B. RESPONDENT'S CRIMINAL CONVICTION

2. On February 10, 2014, Murphy pled guilty to two counts of conspiracy in violation of Title 18, United States Code, Section 371 and to one count of wire fraud in violation of Title 18, United States Code, Section 1343 before the United States District Court for the Western District of North Carolina, in United States v. Phillip Dennis Murphy, Criminal No. 3:12-CR-235-MOC.

3. The counts of the indictment to which Murphy pled guilty charged, among other things, that from at least as early as August 1998 until at least November 2006, Murphy and others unlawfully, willfully, and knowingly did combine, conspire, confederate, and agree together and with each other to commit offenses against the United States of America, namely, to violate Title 18, United States Code, Section 1343, and to defraud the United States of America and an agency thereof, namely, the Internal Revenue Service of the United States Department of the Treasury, all in violation of Title 18, United States Code, Section 371. The indictment also charged that from at least as early as August 1998 until at least November 2006, Murphy and others unlawfully, willfully, and knowingly, having devised and intending to devise a scheme and artifice to defraud municipal issuers and to obtain money and property from these municipal issuers by means of false and fraudulent pretenses, representations, and promises, which scheme affected at least three financial institutions, namely, a scheme to defraud municipal issuers, by causing municipal issuers to award investment agreements and other municipal finance contracts at artificially determined or suppressed levels, and further to deprive municipal issuers of the property right to control their assets by causing them to make economic decisions based on false and misleading information, and for the purpose of executing such scheme and artifice, and attempting to do so, did transmit and cause to be transmitted by means of wire, radio or television communication in interstate commerce, writings, signs, signals, pictures, or sounds, in violation of Title 18, United States Code, Section 1343. Further, the indictment charged that from at least as early as January 1999 until at least May 2002, Murphy and others, unlawfully, willfully and knowingly did combine, conspire, confederate and agree together and with each other to commit offenses against the United States of America, namely, to violate Title 18, United States Code, Section 1005, in violation of Title 18, United States Code, Section 371. It was a part and an object of the conspiracy that Murphy and others, being officers, directors, agents and employees of a certain financial institution, did make and cause to be made entries in the books, reports, and the

[1] On November 1, 2010, BAS was merged into Merrill Lynch, Pierce, Fenner & Smith Incorporated, an indirect wholly-owned subsidiary of Bank of America Corporation, which is registered with the Commission as a broker-dealer.

statements of such bank, for the purpose of deceiving and with the intent to deceive officers of such bank while knowing the entry or entries were false, in violation of Title 18, United States Code, Section 1005. In connection with his guilty plea on February 10, 2014, Murphy admitted that he was, in fact, guilty of the counts set forth in the Bill of Indictment and that he had committed the acts described in the counts in the Bill of Indictment. This criminal case parallels the Commission's settled order in In the Matter of Banc of America Securities, LLC, Exchange Act Release No. 63451 (Dec. 7, 2010).

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act; and

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 203(f) of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent as provided for in the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 210 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-73726; File No. SR-OCC-2014-809)

December 3, 2014

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of an Advance Notice Concerning the Implementation of a Committed Master Repurchase Agreement Program As Part of OCC's Overall Liquidity Plan

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act")[1] and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934[2] notice is hereby given that on November 4, 2014, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the advance notice as described in Items I and II below, which Items have been prepared by OCC. The Commission is publishing this notice to solicit comments on the advance notice from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

This advance notice is filed by OCC in connection with a proposed change to its operations in the form of implementing a committed master repurchase agreement program, as part of OCC's overall liquidity plan.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. The text of these statements may be examined at the places specified in Item IV

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1 12 U.S.C. 5465(e)(1).

2 17 CFR 240.19b-4(n)(1)(i).

below. OCC has prepared summaries, set forth in sections (A) and (B) below, of the most significant aspects of these statements.

(A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants or Others

Written comments on the advance notice were not and are not intended to be solicited with respect to the advance notice and none have been received.

(B) Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Description of Change

This advance notice is being filed in connection with a proposed change to OCC's operations through which OCC would implement a committed master repurchase agreement program, as discussed below, to access an additional committed source of liquidity to meet its settlement obligations.

Background

OCC has been working with a lending agent and an interested institutional investor to develop a program that would allow OCC to access an additional committed source of liquidity that does not increase the concentration of OCC's counterparty exposure, given existing affiliations between a number of commercial banking institutions and OCC's clearing members. The program would take the form of OCC's implementing a committed master repurchase agreement and related confirmations (together, the "Master Repurchase Agreement") with one or more non-bank, non-clearing member institutional investors and their agents.[3]

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[3] The agents for the institutional investors would be responsible for handling administrative aspects of the program on behalf of the investors.

OCC would conduct a due diligence review with respect to each counterparty before entering into a master repurchase arrangement with it. Because the appropriate due diligence activities and financial criteria will vary for each type of counterparty and for each individual counterparty, OCC would determine on a case-by-case basis the specific due diligence criteria it would implement. However, as the principal purpose of these activities would be to obtain assurance that each counterparty has the financial ability to satisfy its obligations under the program, the review would encompass an assessment of the counterparty's financial statements (including external auditor reports thereon) and, as applicable, ratings and/or investment reports. As part of the due diligence process, OCC would identify key criteria relative to monitoring the financial stability of the counterparty on a going forward basis.

Although the Master Repurchase Agreement would be based on the standard form of master repurchase agreement[4] so that it will be more familiar to potential institutional investors, OCC would require the Master Repurchase Agreement to contain certain additional provisions tailored to ensure a reduction in concentration risk, certainty of funding, and operational effectiveness, as described in more detail below. OCC believes that these provisions are necessary and appropriate to integrate the program into its operations and in order to promote safety and soundness consistent with OCC's systemic responsibilities. The terms and conditions applicable to the Master Repurchase Agreement are set forth in the Summary of Indicative Terms attached to this filing as Exhibit 3.

4 The standard form master repurchase agreement is published by the Securities Industry and Financial Markets Association ("SIFMA") and is commonly used in the repurchase market by institutional investors.

The program would be part of OCC's overall liquidity plan, which is meant to provide OCC with access to a diverse set of sources for liquidity, which includes committed credit facilities, securities lending and securities repurchase arrangements, and clearing member funding requirements that, under certain conditions, allow OCC to obtain funds from clearing members.[5]

The Proposed Program: Standard Repurchase Agreement Terms

The Master Repurchase Agreement would generally be structured like a typical repurchase arrangement, in order to help OCC attract interest from potential institutional investors willing to be a counterparty to OCC. Under the Master Repurchase Agreement, the buyer (*i.e.*, the institutional investor) would purchase from OCC from time to time United States government securities ("Eligible Securities").[6] OCC, as the seller, would transfer Eligible Securities to the buyer in exchange for a payment by the buyer to OCC in immediately available funds (the "Purchase Price"). The buyer would simultaneously agree to transfer the purchased securities back to OCC at a specified later date or on OCC's demand (the "Repurchase Date") against the transfer of funds by OCC to the buyer in an amount equal to the outstanding Purchase Price plus the accrued and unpaid

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5 See, e.g., Securities Exchange Act Release No. 72752 (August 4, 2014), 79 FR 46490 (August 8, 2014) (SR-OCC-2014-17), Securities Exchange Act Release No. 71549 (February 12, 2014), 79 FR 03574 (February 19, 2014) (SR-OCC-2014-801) and Securities Exchange Act Release No. 73257 (September 30, 2014), 79 FR 23698 (October 3, 2014) (SR-OCC-2014-806).

6 OCC would use U.S. government securities that are included in clearing fund contributions by clearing members and margin deposits of any clearing member that has been suspended by OCC for the repurchase arrangements. Article VIII, Section 5(e) of OCC's By-Laws and OCC Rule 1104(b) authorize OCC to obtain funds from third parties through securities repurchases using these sources. The officers who may exercise this authority include the Executive Chairman and the President.

price differential (together, the "Repurchase Price"), which is the interest component of the Repurchase Price.

At all times while a transaction is outstanding, OCC would be required to maintain a specified amount of securities or cash margin with the buyer.[7] The market value of the securities supporting each transaction would be determined daily, typically based on a price obtained from a generally recognized pricing source. If the market value of the purchased securities is determined to have fallen below OCC's required margin, OCC would be required to transfer to the buyer sufficient cash or additional securities reasonably acceptable to the buyer so that OCC's margin requirement is satisfied.[8] If the market value of the purchased securities is determined to have risen to above OCC's required margin, OCC would be permitted to require the return of excess purchased securities from the buyer.

As in a typical master repurchase agreement, an event of default would occur with respect to the buyer if the buyer failed to purchase securities on a Purchase Date, failed to transfer purchased securities on any applicable Repurchase Date, or failed to transfer any interest, dividends or distributions on purchased securities to OCC within a specified period after receiving notice of such failure. An event of default would occur with respect to OCC if OCC failed to transfer purchased securities on a Purchase Date or failed to repurchase purchased securities on an applicable Repurchase Date. The Master Repurchase Agreement would also provide for standard events of default for either party,

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7 OCC expects that it would be required to maintain margin equal to 102% of the Repurchase Price, which is a standard rate for arrangements involving U.S. government securities.

8 OCC expects that it would use clearing fund securities and securities posted as margin by defaulting clearing members, as more fully discussed in footnote 7.

including a party's failure to maintain required margin or an insolvency event with respect to the party.

Upon the occurrence of an event of default, the non-defaulting party, at its option, would have the right to accelerate the Repurchase Date of all outstanding transactions between the defaulting party and the non-defaulting party, among other rights. For example, if OCC were the defaulting party with respect to a transaction and the buyer chose to terminate the transaction, OCC would be required to immediately transfer the Repurchase Price to the buyer. If the buyer were the defaulting party with respect to a transaction and OCC chose to terminate the transaction, the buyer would be required to deliver all purchased securities to OCC. If OCC or the buyer did not timely perform, the non-defaulting party would be permitted to buy or sell, or deem itself to have bought or sold, securities as needed to be made whole and the defaulting party would be required to pay the costs related to any covering transactions. Additionally, if OCC was required to obtain replacement securities as a result of an event of default, the buyer would be required to pay the excess of the price paid by OCC to obtain replacement securities over the Repurchase Price.

The Proposed Program: Customized Features to Promote a Reduction in Concentration Risk, Certainty of Funding and Operational Effectiveness

In addition to the master repurchase agreement, OCC would enter into an individualized master confirmation with each buyer and its agent which would set forth certain terms and conditions applicable to all transactions entered into under the Master Repurchase Agreement by that buyer. As discussed above, these required terms and conditions would be designed to promote OCC's goals of reduced concentration risk, certainty of funding and operational effectiveness. The terms of the master confirmations under each Master Repurchase Agreement may vary from one another, because a separate master confirmation will be negotiated for a given buyer at the time that buyer becomes a party to the Master Repurchase Agreement. Because the arrangements between OCC and the individual buyers have not been fully negotiated, OCC has identified the following as key standards that would need to be incorporated into each repurchase arrangement entered into under the program.[9]

Counterparties

OCC would only enter into repurchase arrangements with institutional investors, such as pension funds or insurance companies, that are not OCC clearing members or banks affiliated with any OCC clearing member. This requirement would allow OCC to access stable, reliable sources of funding, without increasing the concentration of its exposure to counterparties that are affiliated banks, broker/dealers and futures commission merchants. This reduction in concentration risk is a key advantage of this proposed program.

Commitment to Fund and Funding Accounts

OCC would seek funding commitments from one or more potential counterparties that would equal $1 billion in the aggregate,[10] with each commitment extending for 364 days or more. Each counterparty would be obligated to enter into transactions under the Master Repurchase Agreement up to its committed amount so long as no default had

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9 OCC expects that the Master Repurchase Agreement will also include other, more routine, provisions such as the method for giving notices and basic due authorization representations by the parties.

10 The $1 billion in commitments could be spread across multiple counterparties, but $1billion represents the proposed aggregate size of the program.

occurred and OCC transferred sufficient Eligible Securities. Each counterparty would be obligated to enter into transactions even if OCC had experienced a material adverse change, such as the failure of a clearing member. This commitment to provide funding would be a key departure from ordinary repurchase arrangements and a key requirement for OCC. Each commitment would be supported by an agreement by the counterparty to maintain cash and investments acceptable to OCC that must be readily converted into cash in a designated account into which OCC had visibility. The creation of a funding account is important because it would provide OCC with two key protections. First, it would help OCC ensure that the committed funds would be available each day, as discussed below. Second, it would facilitate prompt funding by counterparties that are not commercial banks and therefore are not in the business of daily funding.

Funding Mechanics

Funding mechanics would be targeted so that OCC would receive the Purchase Price in immediately available funds within 60 minutes of its request for funds and delivery of Eligible Securities and, if needed, prior to OCC's regular daily settlement time.[11] These targeted funding mechanics would allow OCC to receive needed liquidity in time to satisfy settlement obligations, even in the event of a default by a clearing member or a market disruption. The funding mechanism may be, for example, delivery versus payment/receive versus payment[12] or another method acceptable to OCC that both

11 This would include OCC's regular daily settlement time and any extended settlement time implemented by OCC in an emergency situation under Rule 505.

12 Delivery versus payment/receive versus payment is a method of settlement under which payment for securities must be made prior to or simultaneously with delivery of the securities.

satisfies the objectives of the master repurchase agreement program and presents limited operational risks.

No Rehypothecation

Under the terms of each master confirmation, the buyer would not be permitted to grant any third party an interest in purchased securities, the custody account at the custodian in which purchased securities are held or any cash held in OCC's account. This requirement is important for two reasons. First, because the buyer would be prohibited from rehypothecating purchased securities, the purchased securities should never leave the account and there should be no third-party claims against the purchased securities. Second, the prohibition on rehypothecation would also reduce the risk that a third party could interfere with the buyer's transfer of the purchased securities on the Repurchase Date. Further, the custodian would agree to provide OCC with daily information about each buyer's account. This visibility would allow OCC to act quickly in the event a buyer violates any requirements.

Early Termination Rights

Under the Master Repurchase Agreement, OCC would have the ability to terminate any transaction upon written notice to the buyer, but a buyer would only be able to terminate a transaction upon the occurrence of an event of default with respect to OCC, as further described below. A notice of termination by OCC would specify a new Repurchase Date prior to the originally agreed upon Repurchase Date. Upon the early termination of a transaction, the buyer would be required to return all purchased securities to OCC and OCC would be required to pay the Repurchase Price. This optional early termination right is important to OCC because OCC's liquidity needs may change unexpectedly over time and as a result OCC may not want to keep a transaction outstanding as long as originally planned.

Substitution

Under the Master Repurchase Agreement, OCC would have the ability to substitute any Eligible Securities for purchased securities in its discretion by a specified time, so long as the Eligible Securities satisfy any applicable criteria contained in the Master Repurchase Agreement and the transfer of the Eligible Securities would not create a margin deficit, as described above.[13] This substitution right is important to OCC because it must be able to manage requests of clearing members to return excess or substitute Eligible Securities in accordance with established operational procedures.

Events of Default

Beyond the standard events of default for a failure to purchase or transfer securities on the applicable Purchase Date or Repurchase Date, as described above, OCC would require that the Master Repurchase Agreement not contain any additional events of default that would restrict OCC's access to funding and that it contain an additional default remedy. Most importantly, OCC would require that it would not be an event of default if OCC suffers a "material adverse change".[14] This provision is important because it provides OCC with certainty of funding, even in difficult market conditions.

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13 In addition to its substitution rights, OCC could cause the return of purchased securities by exercising its optional early termination rights under the Master Repurchase Agreement. If OCC were to terminate part or all of a transaction, the buyer would be required to return purchased securities to OCC against payment of the corresponding Repurchase Price.

14 When included in a contract, a "material adverse change" is typically defined as a change that would have a materially adverse effect on the business or financial condition of a company.

Upon the occurrence of an event of default, in addition to the non-defaulting party's right to accelerate the Repurchase Date of all outstanding transactions or to buy or sell securities as needed to be made whole, the non-defaulting party may elect to take the actions specified in the "mini close-out" provision of the Master Repurchase Agreement, rather than declaring an event of default. For example, if the buyer fails to transfer purchased securities on the applicable Repurchase Date, rather than declaring an event of default, OCC may (1) if OCC has already paid the Repurchase Price, require the buyer to repay the Repurchase Price, (2) if there is a margin excess, require the buyer to pay cash or delivered purchased securities in an amount equal to the margin excess, or (3) declare that the applicable transaction, and only that transaction, will be immediately terminated, and apply default remedies under the Master Repurchase Agreement to only that transaction. Therefore, if the buyer fails to deliver purchased securities on any Repurchase Date, OCC would have remedies that allow it to mitigate risk with respect to a particular transaction, without declaring an event of default with respect to all transactions under the Master Repurchase Agreement.

Anticipated Effect on and Management of Risk

OCC believes that the overall impact of the program on the risks presented by OCC would be to reduce settlement risk associated with OCC's operations as a clearing agency. The program would reduce settlement risk by providing an additional source of liquidity, from diversified funding sources that decrease OCC's concentration of risk, with funding certainty and operational efficiency. The resulting reduction in OCC settlement risk would lead to a corresponding reduction in systemic risk and would have a positive impact on the safety and soundness of the clearing system by enabling OCC to have continuous access to funds to settle its obligations to its clearing members. OCC's consistent ability to timely settle its obligations is a key part of OCC's role as a clearing agency and allows OCC to mitigate counterparty risk within the market. In order to sufficiently perform this key role in promoting market stability, it is critical that OCC continuously has access to funds to settle its obligations.

The Master Repurchase Agreement, like any liquidity source, would involve certain risks, but OCC would structure the program to mitigate those risks. Most of these risks are standard in any master repurchase agreement. For example, a buyer could fail to deliver, or delay in delivering, purchased securities to OCC by the applicable Repurchase Date. OCC will address this risk by seeking a security interest from the buyer in that portion of the purchased securities representing the excess of the market value over the Repurchase Price, or by obtaining other comfort from the buyer that the purchased securities will be timely returned. Further, the purchased securities generally will not be "on-the-run" securities, *i.e* the most recently issued Treasury securities. The demand in the marketplace for Treasury securities, for uses other than collateral, is much greater for on-the-run Treasury securities, and therefore, OCC believes buyers will have little incentive to retain the securities transferred by OCC.

The mechanics under the Master Repurchase Agreement would be structured so that OCC could avoid losses by paying the Repurchase Price. For example, OCC will have optional early termination rights in each master confirmation, under which OCC would be able to accelerate the Repurchase Date of any transaction by providing written notice to the buyer and paying the Repurchase Price. Through this mechanism, OCC can maintain the benefit of the Master Repurchase Agreement, while mitigating any risk associated with a particular transaction.

The Master Repurchase Agreement would be structured to avoid potential third-party risks, which are typical of repurchase arrangements. The prohibition on buyer rehypothecation and use of purchased securities, along with OCC's visibility into the buyer's custody account, would reduce the risk to OCC of a buyer default.

As with any repurchase arrangement, OCC is subject to the risk that it may have to terminate existing transactions and accelerate the applicable Repurchase Date with respect to a buyer due to changes in the financial health or performance of the buyer. Terminating transactions could negatively affect OCC's liquidity position. However, any negative effect is reduced by the fact that OCC maintains a number of different financing arrangements, and thus will have access to liquidity sources in the event the Master Repurchase Agreement is no longer a viable source.

Under the Master Repurchase Agreement, OCC would be obligated to transfer additional cash or securities as margin in the event the market value of any purchased securities decreases. OCC seeks to ensure it can meet any such obligation by monitoring the value of the purchased securities and maintaining adequate cash resources to make any required payments. Such payments are expected to be small in comparison to the total amount of cash received for each transfer of purchased securities.

Consistency with the Payment, Clearing and Settlement Supervision Act

OCC believes that the proposed change is consistent with Section 805(b)(1) of the Payment, Clearing and Settlement Supervision Act.[15] The objectives and principles of

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[15] 12 U.S.C. 5464(b)(1).

Section 805(b)(1) of the Payment, Clearing and Settlement Supervision Act specify the promotion of robust risk management, promotion of safety and soundness, reduction of systemic risks and support of the stability of the broader financial system.[16] OCC believes that the proposed change would promote these objectives because the program should provide OCC with an additional source of committed liquidity to meet its settlement obligations while at the same time being structured to mitigate certain operational risks, as described above, that arise in connection with this committed liquidity source.

Accelerated Commission Action Requested

OCC requests that the Commission notify OCC that it has no objection to the change no later than December 12, 2014, in order to allow OCC to implement the master repurchase agreement program beginning in mid-December. OCC requests Commission action to ensure that OCC can access this source of additional liquidity on a timely basis, given the importance of maintaining diverse funding sources in connection with OCC's risk management.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The designated clearing agency may implement this change if it has not received an objection to the proposed change within 60 days of the later of (i) the date that the Commission receives the notice of proposed change, or (ii) the date the Commission receives any further information it requests for consideration of the notice. The designated clearing agency shall not implement this change if the Commission has an objection.

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16 *Id.*

The Commission may, during the 60-day review period, extend the review period for an additional 60 days for proposed changes that raise novel or complex issues, subject to the Commission providing the designated clearing agency with prompt written notice of the extension. The designated clearing agency may implement a change in less than 60 days from the date of receipt of the notice of proposed change by the Commission, or the date the Commission receives any further information it requested, if the Commission notifies the designated clearing agency in writing that it does not object to the proposed change and authorizes the designated clearing agency to implement the change on an earlier date, subject to any conditions imposed by the Commission.

The designated clearing agency shall post notice on its website of proposed changes that are implemented.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-OCC-2014-809 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-OCC-2014-809. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at

http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_14_809.pdf

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-OCC-2014-809 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73733 / December 3, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16295

In the Matter of Alamosa (Delaware), Inc., Amazing Investments, Inc., American Frontiers Marketing Co., American Growth Fund I LP, Americas Gaming International, Inc., and Mammoth Mining Co., Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents Alamosa (Delaware), Inc., Amazing Investments, Inc., American Frontiers Marketing Co., American Growth Fund I LP, Americas Gaming International, Inc., and Mammoth Mining Co.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. Alamosa (Delaware), Inc. (CIK No. 1097722) is a Delaware corporation located in Reston, Virginia with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Alamosa is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended March 31, 2006.

2. Amazing Investments, Inc. (CIK No. 1101353) is a Wyoming corporation located in Draper, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Amazing Investments is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended June 30, 2004.

3. American Frontiers Marketing Co. (CIK No. 1101915) is a dissolved Wyoming corporation located in Tucson, Arizona with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). American Frontiers is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended March 31, 2005, which reported a net loss of $12,906 from the company's October 20, 1999 inception to March 31, 2005.

4. American Growth Fund I LP (CIK No. 924977) is a California corporation located in Las Vegas, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). American Growth Fund I is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on April 1, 1996.

5. Americas Gaming International, Inc. (CIK No. 818475) is a void Delaware corporation located in Reno, Nevada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Americas Gaming is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 1996, which reported a net loss of over $1.68 million for the prior nine months.

6. Mammoth Mining Co. (CIK No. 61796) is a Nevada corporation located in Salt Lake City, Utah with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Mammoth Mining is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on January 2, 2002.

B. DELINQUENT PERIODIC FILINGS

7. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

8. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

9. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73748 / December 4, 2014

Admin. Proc. File No. 3-16131

In the Matter of the Application of Gerald J. Lodovico For Review of Disciplinary Action Taken by FINRA

ORDER GRANTING MOTION TO DISMISS APPLICATION FOR REVIEW

Gerald J. Lodovico, formerly a registered representative associated with Trustmont Financial Group, Inc. ("Trustmont"), seeks review of FINRA disciplinary action. FINRA barred Lodovico from associating with any FINRA member in any capacity as a result of his failure to comply with requests for information, made pursuant to FINRA Rule 8210, regarding his outside business activities and tax liens filed against him.[1] FINRA filed a motion to dismiss Lodovico's application for review, to which Lodovico has not responded. For the reasons set forth below, we have determined to grant FINRA's motion and dismiss this appeal, finding that Lodovico failed to exhaust his administrative remedies.

I. Background

A. Lodovico failed to respond to FINRA's requests for information.

Lodovico was associated with Trustmont from March 2010 to December 2012. The Central Registration Depository ("CRD") record reflects that, while associated with Trustmont, Lodovico worked as the Chief Executive Officer of Sinclair Hathaway Holdings, LLC ("Sinclair Hathaway"), a "private investment company which may trade options and or futures."[2]

1 FINRA Rule 8210(a)(1) states, in relevant part, that "FINRA staff shall have the right to: require a . . . person associated with a member . . . to provide information . . . in writing . . . with respect to any matter involved in the investigation, complaint, examination, or proceeding" authorized by the FINRA By-Laws or rules.

2 FINRA represents that Lodovico provided this information in response to Section 13 of the Uniform Application for Securities Industry Registration or Transfer ("Form U4"), which asks, "Are you *currently* engaged in any other business either as a proprietor, partner, officer, director,
(continued...)

On June 11, 2013, pursuant to Rule 8210, FINRA sent Lodovico a letter (the "First Letter"), by both certified and first-class mail, to his address of record in the CRD.[3] The letter requested that Lodovico provide FINRA with certain financial documents concerning Sinclair Hathaway and information about three tax liens that were filed against him while he was associated with Trustmont.[4] It also informed Lodovico that, although he was no longer associated with a FINRA member firm, he remained subject to FINRA's jurisdiction.[5] The letter further warned Lodovico that sanctions could be imposed against him if he did not respond to FINRA's Rule 8210 request. FINRA requested that Lodovico provide a response by June 24, 2013.[6] Lodovico did not respond to FINRA's Rule 8210 request.

On July 1, 2013, FINRA sent Lodovico a second letter (the "Second Letter"), by certified and first-class mail, requesting that Lodovico provide the information requested in its First Letter. The Second Letter set a July 10, 2013 response deadline and again warned Lodovico that he could be subject to sanctions, including a bar, if he did not deliver the requested information.[7] Once more, Lodovico did not respond to FINRA's Rule 8210 request.

(...continued)
employee, trustee, agent or otherwise?" (emphasis added) and requests the associated person to provide details for an affirmative answer. The Form U4 is not included in the record.

3 A notice issued pursuant to Rule 8210 is deemed received by such person when mailed to his last known residential address as reflected in the CRD. FINRA Rule 8210(d). Formerly registered persons have a "continuing duty" to keep FINRA apprised of their current address. *Warren B. Minton, Jr.*, Exchange Act Release No. 46709, 2002 WL 32140276, at *4 n.15 (Oct. 23, 2002); *see* NASD Notice to Members 97-31, 1997 WL 1909798, at *1-2 (May 1997) (reminding registered persons to keep a current mailing address with NASD "[f]or at least two years *after* an individual registration has been terminated by the filing of . . . [a] Form U5") (emphasis in original). In its motion to dismiss, FINRA states that it mailed all correspondence in this matter to the CRD address of record. In his application for review, Lodovico provides an address that matches the same CRD address.

4 The letter indicated that a search of Allegheny County, Pennsylvania court records revealed that a federal tax lien of $35,251, and two state tax liens, one for $135 and the other for $11,035, had been filed against Lodovico in 2012.

5 Pursuant to Article V, Section 4(c) of the FINRA By-Laws, FINRA retained jurisdiction over Lodovico for two years after he ceased to be associated with Trustmont.

6 The certified letter was returned as unclaimed, but the first-class letter was not returned.

7 Again, the certified letter was returned as unclaimed, but the first-class letter was not returned.

B. FINRA suspended and then barred Lodovico for his failure to respond.

After Lodovico failed to respond, FINRA's Department of Enforcement ("Enforcement") initiated efforts to suspend him. On May 14, 2014, Enforcement sent Lodovico a letter (the "Pre-Suspension Notice"), notifying him that he would be suspended from associating with any FINRA member in any capacity, effective June 9, 2014, for his failure to respond to the prior Rule 8210 requests for information.[8] The Pre-Suspension Notice informed Lodovico that he could take corrective action to prevent the suspension, request a hearing in response to the notice, or, if suspended, request termination of the suspension on the ground of full compliance. The Pre-Suspension Notice warned Lodovico that if he did not request termination of the suspension within three months, he would be barred automatically on August 18, 2014. Lodovico never responded to the notice; nor did he answer the outstanding request for information.

Because Lodovico did not take any action in response to the Pre-Suspension Notice, FINRA sent Lodovico a letter (the "Suspension Notice") on June 9, 2014, notifying him that he was suspended, effective immediately, from association with any FINRA member in any capacity.[9] The Suspension Notice advised Lodovico that he could file a written request to terminate the suspension on the ground of full compliance with the prior requests for information and documents from FINRA. The Suspension Notice also reiterated the warning that Lodovico's failure to seek relief from the suspension by August 18, 2014 would result in an automatic bar pursuant to FINRA Rule 9552(h).[10] Lodovico did not respond.

On August 18, 2014, FINRA notified Lodovico that, effective immediately, he was barred (the "Bar Notice").[11] It also informed Lodovico that any appeal to the Commission had to be filed within thirty days of his receipt of the Bar Notice. On September 16, 2014, Lodovico submitted this timely application for review.

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8 FINRA sent the Pre-Suspension Notice by Federal Express ("FedEx") Overnight Delivery and first-class mail to Lodovico's CRD address. Neither mailing was returned. The FedEx shipment detail for the mailing indicates that it was delivered on May 15, 2014.

9 FINRA sent the Suspension Notice by FedEx Overnight Delivery and first-class mail to Lodovico's CRD address, and, as with the Pre-Suspension Notice, neither mailing was returned. The FedEx shipment detail for the mailing indicates that it was delivered on June 10, 2014.

10 FINRA Rule 9552(h) states, in relevant part, that "a member or person who is suspended under this Rule and fails to request termination of the suspension within three months of issuance of the original notice of suspension will automatically be expelled or barred."

11 FINRA sent the Bar Notice by certified and first-class mail to Lodovico's CRD address. The certified letter was returned as unclaimed, but the first-class letter was not returned.

II. Analysis

We dismiss Lodovico's application for review because he failed to exhaust FINRA administrative remedies before seeking relief from the Commission. Lodovico had the opportunity to avail himself of FINRA's administrative process by taking corrective action, requesting a hearing in response to the notice of suspension, or seeking termination of the suspension on the basis of his full compliance with the information request. But Lodovico did not exercise his rights at any stage of the process before FINRA and thus failed to exhaust his administrative remedies.

We emphasize that "[i]t is clearly proper to require that a statutory right to review be exercised in an orderly fashion, and to specify procedural steps which must be observed as a condition to securing review."[12] Consequently, we will not consider an application for review if the applicant failed to exhaust FINRA's procedures.[13] As the Second Circuit has reasoned:

> Were SRO members, or former SRO members, free to bring their SRO-related grievances before the SEC without first exhausting SRO remedies, the self-regulatory function of SROs could be compromised. Moreover, like other administrative exhaustion requirements, the SEC's promotes the development of a record in a forum particularly suited to create it, upon which the Commission and, subsequently, the courts can more effectively conduct their review. It also provides SROs with the opportunity to correct their own errors prior to review by the Commission. The SEC's exhaustion requirement thus promotes the efficient resolution of disciplinary disputes between SROs and their members and is in harmony with Congress's delegation of authority to SROs to settle, in the first instance, disputes relating to their operations.[14]

In his application for review, Lodovico states that he informed Trustmont in October 2013 that he was "voluntarily relinquishing" his licenses "for life"; that he reported to Trustmont two of the three tax liens against him but was "completely unaware" of the third lien; and that he did not respond to FINRA's Rule 8210 requests because he "assumed" that since he was "voluntarily relinquishing" his licenses, "the point was moot (a regrettable mistake on my part)."

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12 *MFS Sec. Corp.*, Exchange Act Release No. 47626, 2003 WL 1751581, at *29 (Apr. 3, 2003) (citing *Royal Sec. Corp.*, Exchange Act Release No. 5171, 1955 WL 43159, at *277 (May 20, 1955)), *aff'd*, 380 F.3d 611 (2d Cir. 2004).

13 *Caryl Trewyn Lenahan*, Exchange Act Release No. 73146, 2014 WL 4656403, at *2 n.5 (Sept. 19, 2014) (dismissing applicant's appeal for failure to exhaust administrative remedies) (quoting *Ricky D. Mullins*, Exchange Act Release No. 71926, 2014 WL 1390384, at *3 (Apr. 10, 2014)) (same).

14 *MFS Sec. Corp. v. SEC,* 380 F.3d 611, 621-22 (2d Cir. 2004).

Even if we were to accept Lodovico's allegations as true, they do not excuse him from following FINRA's rules, which require compliance with Rule 8210 requests.[15] Lodovico also states that he has "no plans to seek reinstatement [of his licenses]; however, a lifetime ban, especially in light of the internet and today's informational access would tarnish [his] reputation irreparably." Again, this allegation does not excuse Lodovico's failure to respond, because he was responsible for familiarizing himself with the collateral consequences of a bar.[16] Lodovico's application for review must be dismissed because he failed to exhaust his administrative remedies.

Accordingly, IT IS ORDERED that FINRA's motion to dismiss the application for review filed by Gerald J. Lodovico is GRANTED.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

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15 *See* FINRA Rule 8210(c) (stating that "[n]o member or person shall fail to provide information . . . pursuant to this Rule"); *Lenahan*, 2014 WL 4656403, at *3 (rejecting reasons given by applicant to justify her failure to respond to FINRA's rules, which require compliance with Rule 8210 requests).

16 *See Lenahan*, 2014 WL 4656403, at *3 n.10.

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-73749; File No. SR-OCC-2014-810)

December 5, 2014

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Advance Notice Concerning Modifications to Back Testing Procedures in Order to Enhance Monitoring of Margin Coverage and Model Risk Exposure

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010[1] ("Payment, Clearing and Settlement Supervision Act") and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934[2] notice is hereby given that on November 13, 2014, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the advance notice as described in Items I and II below, which Items have been prepared by OCC.[3] The Commission is publishing this notice to solicit comments on the advance notice from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

This advance notice is filed by OCC in connection with a proposed change to its operations (the "Change") in the form of modifications to its back testing procedures in order to enhance its monitoring of margin coverage and model risk exposure.

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1 12 U.S.C. 5465(e)(1).

2 17 CFR 240.19b-4(n)(1)(i).

3 OCC initially filed a similar advance notice on October 31, 2014, as File No. SR-OCC-2014-808. However to correct certain errors in that filing relating to two backtesting program tests, OCC withdrew it and made a new filing (File No. SR-OCC-2014-810) on November 13, 2014.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections (A) and (B) below, of the most significant aspects of these statements.

(A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants or Others

Written comments on the advance notice were not and are not intended to be solicited with respect to the advance notice and none have been received.

(B) Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Description of Change

The proposed Change would modify OCC's back testing procedures in order to enhance its monitoring of margin coverage and model risk exposure. Such monitoring would allow OCC to identify and make improvements to its margin methodology and enhance OCC's ability to manage risk.

OCC has implemented back testing procedures in order to test its methodology for determining the amount of margin to collect from clearing members and validate the assumptions and mechanisms inherent in its methodology and to make any necessary changes to the methodology. Each trading day, OCC estimates the risk on accounts and uses this estimate as a basis for each account's margin charge. On the following business day, OCC's back tests compare an account's observed profit and loss ("P&L") with the prior day's estimated risk using a variety of analytical and statistical tools. These daily tests measure the performance of the account's risk measures, and therefore, also measure the performance of OCC's underlying methodology for calculating these measures. OCC's back testing program enables OCC to assess performance of its margining systems and determine whether financial risks are adequately or inadequately captured by the quantitative models in use.

Currently, OCC employs the "traffic light" test published by the Basel Committee on Banking Supervision in 1996 (the "Traffic Light Test").[4] In conducting the Traffic Light Test, OCC determines the actual number of instances in which the realized loss on an account exceeded the margin, known as an "exceedance," over an observation period of one year. The number of exceedances during the observation period is compared against the number of expected exceedances that are independent and identically distributed over time. OCC will employ an enhanced version of the Traffic Light Test that takes into account the dependency of exceedances between accounts.

OCC has conducted daily back testing of margin accounts since 2006. OCC's staff analyzes the exceedances and makes monthly reports to OCC's Enterprise Risk Management Committee ("ERMC").[5] The reports to the ERMC include pertinent conclusions based on results from the full set of back tests. When back testing reveals the potential opportunity for remediation of OCC's margin methodology, OCC

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4 *See,* "Supervisory Framework for the Use of 'Backtesting' in Conjunction with Internal Model Approach to Market Risk Capital Requirement." Located at http://www.bis.org/publ/bcbs22.htm

5 The Enterprise Risk Management Committee is chaired by the Chief Risk Officer, and consists of the Executive Chairman, Chief Operations Officer, General Counsel, Chief Information Officer, Chief Audit Executive, the Chief Compliance Officer and other members as determined by the Chair.

undertakes a root cause analysis to determine the cause of any issues. Any significant failures of OCC's methodology lead to OCC undertaking a model improvement project designed to correct the problems.

OCC has analyzed its back testing program and identified several enhancements to the program. The following section details the nature of the proposed enhancements.[6]

1. *Proposed Enhancement of and Increase in Statistical Tests*

The proposed changes would enhance existing statistical tests and add three new statistical tests. The first proposed change to OCC's back testing program is that OCC proposes to enhance the Traffic Light Test so that it may be applied to exceedances across all of OCC's margin accounts. Given that exceedances are not independent across margin accounts, OCC will enhance this test so that it will produce a single numerical output that measures aggregation across margin accounts.

In addition to the enhanced Traffic Light Test, OCC will implement other industry standard tests based on exceedances in order to provide a more comprehensive set of tests. The second proposed change to OCC's back testing program is that OCC will add the Kupiec Test,[7] which is a new proportion of failures test that compares the actual number of exceedances with the number that would be expected in light of the confidence level associated with the calculation of margin. For example, when calculating margin with a confidence level of 99%, the number of exceedances is expected to be 1% of the total observations, *i.e.*, the P&Ls for all accounts for all days during the measurement period. If the actual number of exceedances is near the expected

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6 The relevant systems changes are scheduled to be installed on December 5, 2014.

7 *See,* Kupiec, P. "Techniques for Verifying the Accuracy of Risk Management Models," Journal of Derivatives, v3, P73-84. (1995).

number, this is an indication that the calculated margin requirements are accurate estimates of the accounts' estimated losses.

The third proposed change to OCC's back testing program is that OCC will add the Christoffersen Independence Test,[8] which is a new statistical test that measures the extent to which exceedances are independent of each other. Specifically, if OCC's margin models are correctly assessing risk, the probability of an exceedance occurring at any two points in time should be the same as the probability of an exceedance occurring at either point in time, individually, without the exceedance occurring at the other point in time. The fourth proposed change to OCC's back testing program is a new test, the Probtile test, that compares the distribution of the daily observed P&L to the daily forecasted P&L distribution. If the distribution of P&L movement ratios approximates a uniform random distribution, this is an indication that OCC's margin models are providing accurate forecasts of potential losses in an account. Combined, these new statistical tests will provide OCC with the pertinent information necessary to evaluate the effectiveness of its models in determining margin coverage.

2. *Proposed Data Set Changes*

OCC proposes to enhance the data sets being back tested to allow for testing against various assumed portfolio and market data scenarios, in addition to the performance of actual portfolios against actual, current market conditions. First, OCC would back test hypothetical portfolios, allowing for the design and monitoring of portfolios that have magnified sensitivities to particular aspects of the models used in the

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8 *See*, Christoffersen, Peter, "Evaluating Interval Forecasts." International Economic Review, 39 (4), 841-862. (1998).

margin computations. Back testing against hypothetical portfolios would provide a more comprehensive insight into the adequacy of the underlying model assumptions under market conditions prevailing in the back test observation periods.

Under the second data set enhancement, OCC would back test current accounts against earlier observation periods. Currently, accounts are "frozen" by assuming that the time to maturity and the degree to which options are in-the-money or out-of-the-money remain constant during the chosen observation period. The market data observed over the observation period is used to generate the margin forecasts and P&L. Under the enhancement, observation periods would be chosen to reflect special market conditions, which is useful because even though margin coverage might be adequate in the current environment, margin coverage could be inadequate under stressed conditions, such as periods of high volatility. The ability to select specific observation periods would not limit the back testing to the current environments but rather would highlight performance of margin coverage and model performance in market scenarios other than prevailing market conditions.

3. *Proposed Forecast Horizons Changes*

Currently, OCC conducts back testing using a one-day time horizon, which means that it compares calculated margin with realized profit and losses that occur on the business day following the calculation. OCC's margin calculations assume that positions would be liquidated over a two-day period. This test, therefore, compares two-day margin numbers to a one-day profit and loss calculation. OCC's existing back testing methodology makes adjustments in its testing to account for the difference between the two-day liquidation period used in its margin calculation and the one-day horizon used in the profit and loss calculation. OCC intends to revise its back testing methodology to take into account losses over a two-day time horizon, without such adjustments, which would match the two-day liquidation period used in the margin calculation. OCC therefore proposes to implement functionality into its back testing system to conduct a two-day time horizon back test, which will compare calculated margin against a two-day profit and loss calculation. OCC also proposes to revise its back testing methodology to compare one-day margin calculations against one-day profit and loss calculations, and will implement system functionality for such a test. Issues identified in any of these back tests will be reported to the ERMC. OCC believes that its adoption of the additional forecast horizons tests will allow it to have a more accurate view of the sufficiency of its margin methodology.

4. *Proposed Root Cause Analysis Changes*

The proposed Change will improve OCC's ability to conduct root cause analyses by providing OCC's back testing staff with additional, automated, investigation tools. Currently, and when necessary, OCC's back test staff conducts investigations in order to identify the root cause exceedances. The investigation itself is a manual process that is dependent upon the facts and circumstances pertaining to a given exceedance. OCC is now proposing to make system modifications that will provide OCC's back testing staff with addition tools that will facilitate such investigations. Specifically, OCC proposes to add system functionality that will show attribution of losses due to underlying price movements and implied volatility movements. Further, under the improvements OCC would be able to incorporate hypothetical accounts and positions into the tests and would be able to identify risk factors that move above or below the projected values. These changes will improve OCC's ability to conduct investigations that identify the root cause of exceedances, which will in turn lead to improving OCC's back testing methodology and its margin coverage.

Anticipated Effect on and Management of Risk

OCC believes the proposed Change to its back testing procedures would reduce the level of risk presented by OCC because it would enhance OCC's back testing by providing it with more tools to identify gaps in its margin methodology and develop corrective changes thereto.[9] For example, enhanced and increased statistical testing would provide additional information about the adequacy of margin coverage and thus strengthen the assessment of margin and model performance. Changes to data sets would include hypothetical portfolios and earlier observation periods would allow testing of margin coverage under a greater variety of market conditions. Modifying the tests to take into account losses over a two-day period would increase the accuracy of the testing because this two-period matches the assumed liquidation period used in the margin calculations. OCC would also be able to more accurately determine the root cause of exceedances, while rejecting results that incorrectly suggest a needed improvement in its margin methodology, and then would be able to narrowly tailor solutions to the identified root causes. Ultimately, by allowing OCC to more readily and precisely identify gaps in its margin methodology, the Change will reduce risk to OCC and the markets that it serves.

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9 Depending on the nature of a proposed change, it may be necessary for OCC to file a proposed rule change filing or advance notice filing with the Commission.

Consistency with the Payment, Clearing and Settlement Supervision Act

The Change is consistent with Section 805(b)(1) of Payment, Clearing and Settlement Supervision Act because it promotes robust risk management.[10] OCC's receipt of margin from its clearing members protects OCC and market participants from risks presented by the markets OCC serves. OCC uses back testing in order to evaluate the sufficiency and adequacy of the amount of margin it collects from its clearing members. As described above, the Change will provide OCC will [sic] additional tools to identify gaps in its margin methodology. Such identification process will lead to improvements to OCC margin models thereby promoting robust risk management.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date that the Commission receives the notice of proposed change, or (ii) the date the Commission receives any further information it requests for consideration of the notice. The clearing agency shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. A proposed change may be implemented in less than 60 days from the date the advance noticed is filed, or the date further information requested by the Commission is received, if the Commission notifies the clearing agency in writing that it does not object to the proposed change and

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10 12 U.S.C. 5465(b)(1).

authorizes the clearing agency to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

The clearing agency shall post notice on its website of proposed changes that are implemented.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed change, is consistent with the Payment, Clearing and Settlement Supervision Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-OCC-2014-810 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-OCC-2014-810. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with

the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of OCC and on OCC's website
http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_14_810.pdf

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-OCC-2014-810 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73750 / December 5, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3600 / December 5, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16296

In the Matter of **HAMPTON ROADS BANKSHARES, INC.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER AND CIVIL PENALTIES**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Hampton Roads Bankshares, Inc. ("HRBS," "Respondent" or the "Company").

II.

In anticipation of the institution of these proceedings, HRBS has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over HRBS and the subject matter of these proceedings, which are admitted, HRBS consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making

Findings, and Imposing a Cease-and-Desist Order and Civil Penalties ("Order"), as set forth below.

III.

On the basis of this Order and HRBS's Offer, the Commission finds[1] that:

Summary

This matter involves HRBS's accounting treatment in connection with the recording of its deferred tax asset ("DTA") in 2009 and 2010. During 2009 and the first quarter of 2010, HRBS recorded a large DTA without taking a significant valuation allowance against it.[2] HRBS concluded that based on anticipated future earnings, the Company was "more likely than not" to realize its DTA within the applicable carry-forward period. This conclusion was unreasonable because the financial projections underlying HRBS's projections of future earnings were not supportable based on the Company's financial condition, including in particular the ongoing deterioration of its loan portfolio.

HRBS's financial condition was deteriorating by early 2010, and the Company was discussing remedial measures to address its problems. HRBS was facing possible adverse regulatory consequences. In August 2010, HRBS amended its 2009 Form 10-K and first quarter 2010 Form 10-Q to include restated financial statements, reflecting a valuation allowance against the DTA, reducing the reported DTA for 2009 from over $56 million to less than $400,000, and to $0 thereafter. In its restated Form 10-K for 2009, HRBS reported that it was "undercapitalized" as of December 31, 2009, as opposed to "adequately capitalized," as originally reported. Similarly, in its restated Form 10-Q for the first quarter of 2010, HRBS reported that it was "significantly undercapitalized," rather than "undercapitalized" as originally reported.

Accordingly, HRBS violated the reporting, books and records and internal controls provisions of the Exchange Act.

Respondent

1. Hampton Roads Bankshares, Inc., a Virginia corporation with its principal place of business in Virginia Beach, Virginia, is a bank holding company for Bank of Hampton Roads ("BOHR") and Shore Bank ("Shore"), its primary subsidiaries. At all relevant times, HRBS's common stock was registered with the Commission under Section 12(b) of the Securities Exchange

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

[2] HRBS did establish a $1 million valuation allowance in 2009 related to capital losses realized, against the $2.8 million in capital loss carryforwards. However, HRBS recorded a net DTA of $56.38 million in its 2009 Form 10-K, the vast majority of which related to its loan losses.

Act of 1934 (the "Exchange Act") and was listed on the NASDAQ Global Select Market ("NASDAQ"). HRBS was subject to periodic examinations by the Virginia State Corporation Commission's Bureau of Financial Institutions (the "SCC") and the Federal Reserve Bank of Richmond (the "FRB") in 2009 and 2010.

Facts

HRBS History: 2008-09 Mergers and Subsequent Loan Losses

2. HRBS's two primary subsidiaries, BOHR and Shore, provide community and commercial banking services to individuals and small-to-medium-sized businesses in the Hampton Roads region of southeastern Virginia; Richmond, Virginia; the Northeastern and Research Triangle regions of North Carolina; and the Eastern Shore of Virginia and Maryland. HRBS acquired Shore on June 1, 2008. On December 31, 2008, HRBS acquired all outstanding shares of Gateway Financial Holdings, Inc. ("Gateway"). At the time of the acquisition, Gateway's subsidiaries, including Gateway Bank & Trust Co. ("Gateway Bank"), became wholly owned subsidiaries of HRBS. On May 8, 2009, Gateway Bank merged into BOHR, with BOHR being the surviving entity. The acquisition of Gateway increased HRBS's assets from slightly under $1 billion to approximately $3.1 billion.

3. The performance of HRBS's loan portfolio deteriorated during 2009, leading to losses. The Company disclosed in its 2009 Form 10-K that "our problem loans increased significantly in 2009; loans acquired from [Gateway] have been the primary source of that increase. Deteriorating economic conditions, difficulties in loan administration, and insufficient loan collection resources contributed to the credit quality problems." Prior to restating its financials in August 2010, HRBS reported a net loss of $60.7 million for fiscal year 2009, excluding the write down of goodwill of $84.8 million. The company's restated financials reflected a net loss of $116.65 million, excluding the goodwill write-downs.

4. On August 10, 2010, HRBS announced that its financial statements for fiscal year ended December 31, 2009, as included in its 2009 Form 10-K, and the financial statements for the fiscal quarter ended March 31, 2010, as included in its first quarter 2010 Form 10-Q, should no longer be relied upon because HRBS had determined that restatements were necessary to provide for an increase in the valuation allowance against the Company's deferred tax asset. On August 13, 2010, HRBS filed restated annual financial statements for 2009 in an amended Form 10-K for 2009, and restated quarterly financial statements for the quarter ending March 31, 2010, in an amended Form 10-Q. The restated financial statements included a valuation allowance of approximately $56 million for the year ended December 31, 2009, and of an additional $14.3 million for the first quarter of 2010. These valuation allowances reduced HRBS's reported DTA as of year-end 2009 from $56.4 million to $397,000, and as of March 31, 2010 from $70.3 million to $0.

Deferred Tax Assets: Description and Accounting Guidance

5. Accounting Standard Codification (ASC) 740 (formerly FASB statement 109) establishes standards for companies to account for and report the effects of income taxes. A

deferred tax asset is an asset on a company's balance sheet that represents the right to offset a future tax expense or obligation with a future tax benefit or refund. These assets arise as a result of timing differences that occur between reporting the effect of taxes accounted for under U.S. GAAP and calculating tax benefits and liabilities under the enacted tax law. For example, due to differences between tax laws and accounting standards for financial statement purposes, some events are recognized for financial reporting purposes and for tax purposes in different years. This can give rise to differences between the tax bases of assets or liabilities and their reported amounts in financial statements. These differences are temporary because the event will become taxable or deductible in the future. A deferred tax asset, or DTA, exists when temporary timing differences are more likely than not to result in deductible amounts in future years. Deferred tax assets can arise in connection with a company's allowance for loan and lease losses (ALLL), which was the case for the vast majority of HRBS's DTA.

6. A DTA is recorded on the balance sheet when it is more likely than not that the DTA will be realized in a future period. However, ASC 740-10-30 requires a company to "[r]educe deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the deferred tax assets will not be realized. The valuation allowance shall be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized." The company must weigh all positive and negative evidence in determining whether a valuation allowance is necessary.

7. When considering the weighing of positive and negative evidence, the accounting guidance under ASC 740-10-30-21 and -23 states: "[f]orming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as cumulative losses in recent years," and "[a] cumulative loss in recent years is a significant piece of negative evidence that is difficult to overcome." ASC 740-10-30-21 provides other examples of negative evidence, including "losses expected in early future years (by a presently profitable entity)" and "unsettled circumstances that, if unfavorably resolved, would adversely affect future operations and profit levels on a continuing basis in future years." The realizability of DTAs must be evaluated in each reporting period.

<u>HRBS's Loan Losses and Increasing DTA</u>

8. Prior to 2008, HRBS did not record a significant DTA. As of the end of 2007, the Company recorded a net DTA of $2.66 million, and that number decreased through the first three quarters of 2008. Gateway, however, had seen an increase in its DTA during 2008 due to a deteriorating loan portfolio and a corresponding increase in loan losses. As of the end of 2008 – following the merger with Gateway – HRBS recorded a DTA of $32.6 million.

9. As HRBS disclosed in its Form 10-K for 2009, "our problem loans increased significantly in 2009; loans acquired from [Gateway] have been the primary source of that increase. Deteriorating economic conditions, difficulties in loan administration, and insufficient loan collection resources contributed to the credit quality problems." Prior to its restatement, HRBS reported $60.7 million in losses for 2009 (exclusive of its goodwill write-downs), and

recorded provisions for loan losses of $33.71 million, $33.66 million, $65.67 million, and $45.61 million for the second, third and fourth quarters of 2009 and the first quarter of 2010, respectively.

10. Consequently, after a slight dip in the first quarter of 2009 from $32.62 million to $31.28 million, HRBS'S DTA increased through the end of the first quarter of 2010 along with the company's loan losses. HRBS recorded a DTA of $44.22 million for the second quarter of 2009, $37.00 million for the third quarter of 2009, and $56.38 million for the fourth quarter and year-end of 2009, and $70.32 million in the first quarter of 2010.

11. The vast majority of the DTA recorded by HRBS for 2009 and the first quarter of 2010 related to the Company's loan losses. Prior to its restatement in August 2010, HRBS did not establish a valuation allowance against its DTA relating to its loan losses. The only valuation allowance HRBS established against its DTA in this period was a $1 million allowance relating to capital losses realized, against the Company's $2.8 million in capital loss carryforwards.

<u>HRBS's DTA Analysis</u>

12. In November 2009, HRBS undertook an analysis of "whether we can continue to justify carrying [the deferred tax assets] at the amount they are recorded in the general ledger." The resulting memorandum concluded no valuation allowance was required. The memorandum was based in part on capital projections forecasting loan performance through the end of 2010, which assumed the Company would work through existing non-performing loans ("NPLs") in 24-36 months and would earn a consistent $8.4 million in quarterly pre-tax, pre-provision income ($33.6 million annually). These conclusions were not reasonable. The projections underlying the analysis assumed that the Company's provision for loan losses would drop from over $33 million in third quarter 2009 to $2.35 million by the end of 2010. However, at the same time, internal company reports reflected that as of November 2009, the company's total delinquent and non-accruing loans had reached nearly $350 million, or 13.4% of total loans, an increase over the quarter-end totals for each of the first through third quarters of 2009. Likewise, non-performing assets had increased 11% from September to October 2009, continuing a trend of increases in problem loans since late 2008. HRBS reported a provision for loan losses for the third quarter of 2009 of $33.7 million, and for fourth quarter 2009 of $65.7 million. Further, HRBS's DTA analysis relied on "pre-tax, pre-provision" income, and did not address the fact that the existing loan loss provisions were the single greatest driver of the Company's losses at the time, and that loan losses would be based on the trends noted above indicating that these losses would likely continue.

13. From December 2009 through July 2010, HRBS provided materials to the SEC's Division of Corporation Finance ("Corp Fin") and Office of the Chief Accountant ("OCA") concerning its conclusions that a valuation allowance was not required on its DTA, and that the financial projections supporting its analysis were supportable, notwithstanding the fact that the Company's loan losses in 2009 had exceeded the aggregate taxable income for the prior three years, and were continuing.

14. In March of 2010, the Company drafted an internal memorandum setting forth an analysis of the necessity of a valuation allowance against the DTA as of year-end 2009. HRBS retained an outside accounting consultant to provide limited assistance in directing the Company to the appropriate accounting guidance and memorializing the Company's conclusions.[3] The March 2010 memorandum concluded that HRBS would more likely than not earn the necessary $8 million future taxable income per year ($150-160 million total) necessary to fully utilize the DTA over the applicable carry-forward period. The analysis relied, in part, on the Company's historical pre-Gateway earnings over the prior four years ($5.5 million, $6.0 million, $6.8 million, and $7.2 million for 2005-08, respectively), concluding that the Company would more likely than not earn the necessary $8 million future taxable income per year. The memorandum recognized that excluding non-recurring write-offs of goodwill associated with Shore Bank and Gateway, HRBS had suffered $64 million in pre-tax losses in 2009, which was "approximately double the income earned over the prior 5 years," but noted that HRBS "do[es] not expect losses to continue past 2011." At the time HRBS drafted this analysis, total loans past due had trended upward since the beginning of 2009, and total delinquent and nonaccrual loans, while slightly lower than in February 2010, remained at historically high levels.

15. On April 23, 2010, HRBS filed its Form 10-K for 2009, which incorporated financial statements recording a DTA of $56.38 million, including a valuation allowance of $1.0 million established against the Company's $2.8 million in capital loss carryforwards, but no valuation allowance relating to the remainder of the DTA, including the portion of the DTA attributable to loan losses. The March 2010 DTA memorandum reflecting HRBS's rationale for this accounting decision was substantially reproduced in the footnotes to the financial statements included in the Company's 2009 Form 10-K.

16. In May 2010, HRBS updated its analysis of whether a valuation allowance was required on the DTA for purposes of HRBS's first quarter 2010 financial statements. The identification and weighing of positive and negative evidence remained substantively unchanged from the March 2010 memorandum, though the updated memorandum noted that the required annual taxable income to fully utilize the Company's DTA was now an average of $9 million, rather than $8 million. The May 2010 memorandum supported its conclusion that this level would likely be reached by, in part, noting that HRBS, Gateway and Shore Bank had earned a combined $31 million in 2007, the last full year prior to the mergers. The memorandum predicted that HRBS would become profitable in 2011, and attached bank-level capital projections forecasting a slight profit as of third quarter of 2011, notwithstanding HRBS's internal consolidated projections less than two months prior that projected quarterly losses of at least $7 million through 2011. Internal Company reports as of late May 2010 reflected continuing deterioration of HRBS's loan portfolio through increasing levels of classified loans, past due loans, delinquent and nonaccrual loans, and nonperforming loans as a percentage of total loans.

17. On May 17, 2010, HRBS filed its Form 10-Q for the quarterly period ended March 31, 2010. The Form 10-Q incorporated financial statements recording a DTA of $70.32 million,

[3] The outside accounting consultant did not provide an opinion on the validity of the company's conclusions and relied on the projections and assumptions that HRBS used in performing its DTA analysis.

including the previously-established a valuation allowance of $1.0 million against HRBS's $2.8 million in capital loss carryforwards. The financial statements again established no valuation allowance relating to the remainder of the DTA, including the portion of the DTA attributable to loan losses.

18. HRBS continued to contend, following the filing of its Form 10-Q for the first quarter of 2010, that no valuation allowance was required on its DTA. In June and July 2010, HRBS presented new financial projections to support its position, forecasting a net loss in 2010 of $68 million, but profits in 2011 and 2012 of $26 million and $50 million, respectively. To explain this projected return to profitability, HRBS noted in a June 2010 submission to Corp Fin that "[t]he rate of deterioration in the portfolio has slowed, as evidenced by the reduction in growth of NPLs from December 31, 2009 to March 31, 2010, a stabilization in the pace of credit downgrades within the Company's risk rating system and a stabilization in delinquency levels from the end of 2009." At that time, HRBS's internal reports showed that as of May 2010, total loans past due as a percentage of total loans topped 14% for the first time, having increased steadily since being 4% as of December 2008. At the same time, Special Mention loans[4] increased above $300 million to their highest level ever to that point, and classified loans[5] increased $6.4 million to $591.2 million, also their highest level ever. While non-performing loans decreased $3.9 million from April 2010 to May 2010, or by 0.1% to 12.7% of total loans, non-performing loans increased in June by $32.5 million, from 12.7% to 14.4% of total loans, compared to approximately 10% as of December 2009.

19. The financial projections HRBS used in June and July 2010 to support its position on the DTA forecasted a dramatic decrease in the provision for loan losses for the remainder of 2010 after the second quarter. The Company projected a $46.5 million provision for the second quarter, $8 million in the third quarter, and a provision of $0 in the fourth quarter. Notwithstanding the fact that HRBS was already into its third quarter of 2010 when it used these projections in July 2010, the projections contrasted with the Company's actual reported loan loss provisions for those same periods. Indeed, the Company reported loan loss provisions of $54.6 million, $83.7 million and $27.9 million for the second, third and fourth quarters of 2010 respectively.

20. On August 13, 2010, HRBS issued an amended Form 10-K/A for 2009 and an amended Form 10-Q/A for the first quarter of 2010, restating the financial results for those periods to reflect a valuation allowance against the entire DTA.

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[4] HRBS's internal reports describe "Special Mention" as loans on the "watch list." Bank regulators define a "Special Mention" asset as an asset that "has potential weaknesses that deserve management's close attention" and that "[i]f left uncorrected... may result in deterioration of the repayment prospects for the asset or in the institution's credit position at some future date."

[5] HRBS's internal reports defined "classified" loans as including (i) "substandard" loans that were "inadequately protected by the current sound net worth and paying capacity of the obligor or of the collateral pledged, if any"; (ii) "doubtful" loans with "weaknesses [that] make collection or liquidation in full on the basis of currently existing facts, conditions, and values highly questionable and improbable"; and (iii) "loss" loans that were "considered uncollectable and of such little value that their continuance as bankable assets is not warranted."

The Effects of HRBS's DTA On Its Reported Capitalization Levels

21. The valuation allowance against HRBS's DTA played a role in determining the company's capitalization level, a measure that banks are required to report quarterly under bank regulations. A portion of a bank's DTA is included in its Tier 1 capital calculation. Prior to its restatement, HRBS reported that it was "adequately capitalized" as of December 31, 2009, and "undercapitalized" as of March 31, 2010. Following the restatement, HRBS changed this statement to report that it was "undercapitalized" as of December 31, 2009, and "significantly undercapitalized" as of March 31, 2010.

22. Changes in regulatory classification are material information to investors. A bank that falls below certain regulatory capital classifications can be subject to adverse regulatory actions by bank regulators that severely restrict its activities. Such activities can include the requirement that a bank that becomes "undercapitalized" submit and obtain approval of a "capital restoration plan," and may also include requiring the institution to be recapitalized, prohibiting asset growth, restricting interest rates paid, requiring prior approval of capital distributions by a controlling bank holding company, requiring new election of directors or dismissal of directors and officers, and requiring regulatory approval of proposed dividends or consent to consolidation or divestiture of the institution or its affiliates. In HRBS's case, the Company and its banking regulators entered into a written agreement imposing certain operational and transactional limitations, which has recently been lifted.

Violations

23. As a result of the conduct described above, HRBS violated Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder, which require every issuer of securities registered pursuant to Section 12 of the Exchange Act to file with the Commission accurate periodic reports, including annual reports on Form 10-K and quarterly reports on Form 10-Q, and mandate that the required reports must contain any further material information necessary to make the required statements made in the reports not misleading.

24. As a result of the conduct described above, HRBS violated Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

25. As a result of the conduct described above, HRBS violated Section 13(b)(2)(B) of the Exchange Act, which requires issuers of securities registered pursuant to Section 12 of the Exchange Act to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles.

HRBS's Remedial Efforts

26. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent, including improvements to HRBS's policies and procedures relating to internal controls over financial reporting.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in the Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. HRBS cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder.

B. HRBS shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $200,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

> (1) HRBS may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;
>
> (2) HRBS may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or
>
> (3) HRBS may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:
>
> > Enterprise Services Center
> > Accounts Receivable Branch
> > HQ Bldg., Room 181, AMZ-341
> > 6500 South MacArthur Boulevard
> > Oklahoma City, OK 73169

C. Payments by check or money order must be accompanied by a cover letter identifying Hampton Roads Bankshares, Inc. as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Scott Friestad, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010.

D. Amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, HRBS agrees that in any Related Investor Action, it shall not argue that it is entitled to, nor shall it benefit by, offset or reduction of any award of compensatory damages by the amount of any part of HRBS's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, HRBS agrees that it shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against HRBS by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Commissioner Piwowar
dissent as to penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73751 / December 5, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3601 / December 5, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16297

In the Matter of **NEAL A. PETROVICH, CPA,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Neal A. Petrovich, CPA ("Petrovich" or "Respondent").

II.

In anticipation of the institution of these proceedings, Petrovich has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over Petrovich and the subject matter of these proceedings, which are admitted, Petrovich consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Petrovich's Offer, the Commission finds[1] that:

Summary

This matter involves the accounting treatment by Hampton Roads Bankshares, Inc. ("HRBS" or the "Company") in connection with the recording of its deferred tax asset ("DTA") in 2009 and 2010. Petrovich was the Chief Financial Officer of HRBS from February 2009 through May 2010. During 2009 and the first quarter of 2010, HRBS recorded a large DTA without taking a significant valuation allowance against it.[2] HRBS, relying on an analysis performed under Petrovich's direction, concluded that based on anticipated future earnings, the Company was "more likely than not" to realize its DTA within the applicable carry-forward period. This conclusion was unreasonable because the financial projections underlying HRBS's projections of future earnings were not supportable based on the Company's financial condition, including in particular the ongoing deterioration of its loan portfolio.

HRBS's financial condition was deteriorating by early 2010, and the Company was discussing remedial measures to address its problems. HRBS was facing possible adverse regulatory consequences. In August 2010, HRBS amended its 2009 Form 10-K and first quarter 2010 Form 10-Q to include restated financial statements, reflecting a valuation allowance against the DTA, reducing the reported DTA for 2009 from over $56 million to less than $400,000, and to $0 thereafter. In its restated Form 10-K for 2009, HRBS reported that it was "undercapitalized" as of December 31, 2009, as opposed to "adequately capitalized," as originally reported. Similarly, in its restated Form 10-Q for the first quarter of 2010, HRBS reported that it was "significantly undercapitalized," rather than "undercapitalized" as originally reported.

Accordingly, Petrovich was a cause of HRBS's violations of the reporting, books and records and internal controls provisions of the Exchange Act.

Respondent

1. Neal Petrovich, 52, is a resident of Chesapeake, Virginia, and was HRBS's Executive Vice President and CFO from February 2009 through May 2010. On May 13, 2010, Petrovich informed HRBS of his intention to end his employment with HRBS effective June 4, 2010, and he left the company on that date. Petrovich is currently employed as Senior Vice President – Finance with a publicly traded financial services company in the area. He is a licensed CPA in Virginia.

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[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

[2] HRBS did establish a $1 million valuation allowance in 2009 related to capital losses realized, against the $2.8 million in capital loss carryforwards. However, HRBS recorded a net DTA of $56.38 million in its 2009 Form 10-K, the vast majority of which related to its loan losses.

Other Relevant Entity

2. Hampton Roads Bankshares, Inc., a Virginia corporation with its principal place of business in Virginia Beach, Virginia, is a bank holding company for Bank of Hampton Roads ("BOHR") and Shore Bank ("Shore"), its primary subsidiaries. At all relevant times, HRBS's common stock was registered with the Commission under Section 12(b) of the Securities Exchange Act of 1934 (the "Exchange Act") and was listed on the NASDAQ Global Select Market ("NASDAQ"). HRBS was subject to periodic examinations by the Virginia State Corporation Commission's Bureau of Financial Institutions (the "SCC") and the Federal Reserve Bank of Richmond (the "FRB") in 2009 and 2010.

Facts

HRBS History: 2008-09 Mergers and Subsequent Loan Losses

3. HRBS's two primary subsidiaries, BOHR and Shore, provide community and commercial banking services to individuals and small-to-medium-sized businesses in the Hampton Roads region of southeastern Virginia; Richmond, Virginia; the Northeastern and Research Triangle regions of North Carolina; and the Eastern Shore of Virginia and Maryland. HRBS acquired Shore on June 1, 2008. On December 31, 2008, HRBS acquired all outstanding shares of Gateway Financial Holdings, Inc. ("Gateway"). At the time of the acquisition, Gateway's subsidiaries, including Gateway Bank & Trust Co. ("Gateway Bank"), became wholly owned subsidiaries of HRBS. On May 8, 2009, Gateway Bank merged into BOHR, with BOHR being the surviving entity. The acquisition of Gateway increased HRBS's assets from slightly under $1 billion to approximately $3.1 billion.

4. The performance of HRBS's loan portfolio deteriorated during 2009, leading to losses. The Company disclosed in its 2009 Form 10-K that "our problem loans increased significantly in 2009; loans acquired from [Gateway] have been the primary source of that increase. Deteriorating economic conditions, difficulties in loan administration, and insufficient loan collection resources contributed to the credit quality problems." Prior to restating its financials in August 2010, HRBS reported a net loss of $60.7 million for fiscal year 2009, excluding the write down of goodwill of $84.8 million. The company's restated financials reflected a net loss of $116.65 million, excluding the goodwill write-downs.

5. On August 10, 2010, HRBS announced that its financial statements for fiscal year ended December 31, 2009, as included in its 2009 Form 10-K, and the financial statements for the fiscal quarter ended March 31, 2010, as included in its first quarter 2010 Form 10-Q, should no longer be relied upon because HRBS had determined that restatements were necessary to provide for an increase in the valuation allowance against the Company's deferred tax asset. On August 13, 2010, HRBS filed restated annual financial statements for 2009 in an amended Form 10-K for 2009, and restated quarterly financial statements for the quarter ended March 31, 2010, in an amended Form 10-Q. The restated financial statements included a valuation allowance of approximately $56 million for the year ended December 31, 2009, and of an additional $14.3 million for the first quarter of 2010. These valuation allowances reduced HRBS's reported DTA as of year-end 2009 from $56.4 million to $397,000, and as of March 31, 2010 from $70.3 million to $0.

Deferred Tax Assets: Description and Accounting Guidance

6. Accounting Standard Codification (ASC) 740 (formerly FASB statement 109) establishes standards for companies to account for and report the effects of income taxes. A deferred tax asset is an asset on a company's balance sheet that represents the right to offset a future tax expense or obligation with a future tax benefit or refund. These assets arise as a result of timing differences that occur between reporting the effect of taxes accounted for under U.S. GAAP and calculating tax benefits and liabilities under the enacted tax law. For example, due to differences between tax laws and accounting standards for financial statement purposes, some events are recognized for financial reporting purposes and for tax purposes in different years. This can give rise to differences between the tax bases of assets or liabilities and their reported amounts in financial statements. These differences are temporary because the event will become taxable or deductible when the related asset is recovered or the related liability is settled. A deferred tax asset, or DTA, exists when these temporary timing differences are more likely than not to result in deductible amounts in future years. Deferred tax assets can arise in connection with a company's allowance for loan and lease losses (ALLL), which was the case for the vast majority of HRBS's DTA.

7. The negative financial statement impact of ALLL may be partially offset by the positive impact of a DTA in a corresponding amount. Pursuant to the applicable accounting principles, certain conditions need to be met for the DTA to be recorded on the balance sheet. The relevant accounting provision, ASC 740-10-30, requires a company to "[r]educe deferred tax assets by a valuation allowance if, based on the weight of available evidence, it is more likely than not (a likelihood of more than 50 percent) that some portion or all of the deferred tax assets will not be realized. The valuation allowance shall be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized." The company must weigh all positive and negative evidence in determining whether a valuation allowance is necessary.

8. The accounting guidance further states, at ASC 740-10-30-21 and -23, that "[f]orming a conclusion that a valuation allowance is not needed is difficult when there is negative evidence such as cumulative losses in recent years," and "[a] cumulative loss in recent years is a significant piece of negative evidence that is difficult to overcome." ASC 740-10-30-21 also notes that other examples of negative evidence include "losses expected in early future years (by a presently profitable entity)" and "unsettled circumstances that, if unfavorably resolved, would adversely affect future operations and profit levels on a continuing basis in future years." The realizability of DTAs must be evaluated in each reporting period.

HRBS's Loan Losses and Increasing DTA

9. Prior to 2008, HRBS did not record a significant DTA. As of the end of 2007, the Company recorded a net DTA of $2.66 million, and that number decreased through the first three quarters of 2008. Gateway, however, had seen an increase in its DTA during 2008 due to a deteriorating loan portfolio and a corresponding increase in loan losses. As of the end of 2008 – following the merger with Gateway – HRBS recorded a DTA of $32.6 million.

10. As HRBS disclosed in its Form 10-K for 2009, "our problem loans increased significantly in 2009; loans acquired from [Gateway] have been the primary source of that increase. Deteriorating economic conditions, difficulties in loan administration, and insufficient loan collection resources contributed to the credit quality problems." Prior to its restatement, HRBS reported $60.7 million in losses for 2009 (exclusive of its goodwill write-downs), and recorded provisions for loan losses of $33.71 million, $33.66 million, $65.67 million, and $45.61 million for the second, third and fourth quarters of 2009 and the first quarter of 2010, respectively.

11. Consequently, after a slight dip in the first quarter of 2009 from $32.62 million to $31.28 million, HRBS'S DTA increased through the end of the first quarter of 2010 along with the company's loan losses. HRBS recorded a DTA of $44.22 million for the second quarter of 2009, $37.00 million for the third quarter of 2009, $56.38 million for the fourth quarter and year-end of 2009, and $70.32 million in the first quarter of 2010.

12. The vast majority of the DTA recorded by HRBS for 2009 and the first quarter of 2010 related to the Company's loan losses. Prior to its restatement in August 2010, HRBS did not establish a valuation against its DTA relating to its loan losses. The only valuation allowance HRBS established against its DTA in this period was a $1 million allowance relating to capital losses realized, against the Company's $2.8 million in capital loss carryforwards.

HRBS's DTA Analysis

13. In November 2009, HRBS, under Petrovich's direction, conducted an analysis of "whether [HRBS] can continue to justify carrying [the deferred tax assets] at the amount they are recorded in the general ledger." The resulting memorandum concluded no valuation allowance was required. The memorandum was based in part on capital projections forecasting loan performance through the end of 2010, prepared by Petrovich and others under his direction, which assumed the Company would work through existing non-performing loans ("NPLs") in 24-36 months and would earn a consistent $8.4 million in quarterly pre-tax, pre-provision income ($33.6 million annually). Petrovich knew or should have known that these conclusions were not reasonable. The projections underlying the analysis assumed that the provision for loan losses would drop from over $33 million in third quarter 2009 to $2.35 million by the end of 2010. However, at the same time, internal company reports that were circulated to Petrovich reflected that as of November 2009, the company's total delinquent and non-accruing loans had reached nearly $350 million, or 13.4% of total loans, an increase over the quarter-end totals for each of the first through third quarters of 2009. Likewise, non-performing assets had increased 11% from September to October 2009, continuing a trend of increases in problem loans since late 2008. HRBS reported a provision for loan losses for the third quarter of 2009 of $33.7 million, and for fourth quarter 2009 of $65.7 million. Further, HRBS's DTA analysis relied on "pre-tax, pre-provision" income, and did not address the fact that the existing loan loss provisions were the single greatest driver of the Company's losses at the time, and that the trends noted above indicated that these losses would likely continue.

14. From December 2009 through July 2010, HRBS provided materials to the SEC's Division of Corporation Finance ("Corp Fin") and Office of the Chief Accountant ("OCA") concerning its conclusions that a valuation allowance was not required on its DTA, and that the

financial projections supporting its analysis were supportable, notwithstanding the fact that the Company's loan losses in 2009 had exceeded the aggregate taxable income for the prior three years, and were continuing.

15. In March of 2010, Petrovich and others under his direction prepared an internal memorandum setting forth an analysis of the necessity of a valuation allowance against the DTA as of year-end 2009. HRBS retained an outside accounting consultant to provide limited assistance in directing the Company to the appropriate accounting guidance and memorializing the Company's conclusions.[3] The March 2010 memorandum concluded that HRBS would more likely than not earn the necessary $8 million future taxable income per year ($150-160 million total) necessary to fully utilize the DTA over the applicable carry-forward period. The analysis relied, in part, on the Company's historical pre-Gateway earnings over the prior four years ($5.5 million, $6.0 million, $6.8 million, and $7.2 million for 2005-08, respectively), concluding that the Company would more likely than not earn the necessary $8 million future taxable income per year. The memorandum recognized that excluding non-recurring write-offs of goodwill associated with Shore Bank and Gateway, HRBS had suffered $64 million in pre-tax losses in 2009, which was "approximately double the income earned over the prior 5 years," but noted that HRBS "do[es] not expect losses to continue past 2011." Petrovich knew or should have known that the conclusions in the March 2010 memorandum were not reasonable. At the time this analysis was drafted, total loans past due had trended upward since the beginning of 2009, and total delinquent and nonaccrual loans, while slightly lower than in February 2010, remained at historically high levels.

16. On April 23, 2010, HRBS filed its Form 10-K for 2009, signed by Petrovich, which incorporated financial statements recording a DTA of $56.38 million, including a valuation allowance of $1.0 million established against the Company's $2.8 million in capital loss carryforwards, but no valuation allowance relating to the remainder of the DTA, including the portion of the DTA attributable to loan losses. The March 2010 DTA memorandum reflecting HRBS's rationale for this accounting decision was substantially reproduced in the footnotes to the financial statements included in the Company's 2009 Form 10-K.

17. In May 2010, HRBS, under Petrovich's direction, updated the analysis of whether a valuation allowance was required on the DTA for purposes of HRBS's first quarter 2010 financial statements. The identification and weighing of positive and negative evidence remained substantively unchanged from the March 2010 memorandum, though the updated memorandum noted that the required annual taxable income to fully utilize the Company's DTA was now an average of $9 million, rather than $8 million. The May 2010 memorandum supported its conclusion that this level would likely be reached by, in part, noting that HRBS, Gateway and Shore Bank had earned a combined $31 million in 2007, the last full year prior to the mergers. The memorandum predicted that HRBS would become profitable in 2011, and attached bank-level capital projections, also drafted by Petrovich and others under his direction, that forecasted a slight profit as of third quarter of 2011, notwithstanding the Company's internal consolidated projections less than two months prior that projected quarterly losses of at least $7 million through 2011. Petrovich knew or should have known that the conclusions in the May 2010 memorandum were

[3] The outside accounting consultant did not provide an opinion on the validity of the company's conclusions and relied on the projections and assumptions that HRBS used in performing the DTA analysis.

not reasonable. Internal Company reports as of late May 2010 reflected continuing deterioration of HRBS's loan portfolio through increasing levels of classified loans, past due loans, delinquent and nonaccrual loans, and nonperforming loans as a percentage of total loans.

18. On May 17, 2010, HRBS filed its Form 10-Q for the quarterly period ended March 31, 2010. The Form 10-Q incorporated financial statements recording a DTA of $70.32 million, including the previously-established a valuation allowance of $1.0 million against HRBS's $2.8 million in capital loss carryforwards. The financial statements again established no valuation allowance relating to the remainder of the DTA, including the portion of the DTA attributable to loan losses.

19. On May 13, 2010, Petrovich informed HRBS's Board of Directors and senior management of his intention to end his employment with the Company, effective June 4, 2010. On June 4, 2010, Petrovich left HRBS.

20. On August 13, 2010, HRBS issued an amended Form 10-K/A for 2009 and an amended 10-Q/A for the first quarter of 2010, restating the financial results for those periods to reflect a valuation allowance against the entire DTA.

The Effects of HRBS's DTA On Its Reported Capitalization Levels

21. The valuation allowance against HRBS's DTA played a role in determining the Company's capitalization level, a measure that banks are required to report quarterly under bank regulations. A portion of a bank's DTA is included in its Tier 1 capital calculation. Prior to its restatement, HRBS reported that it was "adequately capitalized" as of December 31, 2009, and "undercapitalized" as of March 31, 2010. Following the restatement, HRBS changed this statement to report that it was "undercapitalized" as of December 31, 2009, and "significantly undercapitalized" as of March 31, 2010.

22. Changes in regulatory classification are material information to investors. A bank that falls below certain regulatory capital classifications can be subject to adverse regulatory actions by bank regulators that severely restrict its activities. Such activities can include the requirement that a bank that becomes "undercapitalized" submit and obtain approval of a "capital restoration plan," and may also include requiring the institution to be recapitalized, prohibiting asset growth, restricting interest rates paid, requiring prior approval of capital distributions by a controlling bank holding company, requiring new election of directors or dismissal of directors and officers, and requiring regulatory approval of proposed dividends or consent to consolidation or divestiture of the institution or its affiliates.

Violations

23. As a result of the conduct described above, Petrovich was a cause of HRBS's violation of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1, and 13a-13 thereunder, which require every issuer of securities registered pursuant to Section 12 of the Exchange Act to file with the Commission accurate periodic reports, including annual reports on Form 10-K and quarterly reports on Form 10-Q, and mandate that the required reports must contain any further

material information necessary to make the required statements made in the reports not misleading.

24. As a result of the conduct described above, Petrovich was a cause of HRBS's violation of Section 13(b)(2)(A) of the Exchange Act, which requires reporting companies to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect their transactions and dispositions of their assets.

25. As a result of the conduct described above, Petrovich was a cause of HRBS's violation of Section 13(b)(2)(B) of the Exchange Act, which requires issuers of securities registered pursuant to Section 12 of the Exchange Act to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles.

Undertaking

Petrovich has agreed to the following undertaking:

Petrovich shall, within 10 days of the entry of an Order, make a payment in the nature of a penalty in the amount of $25,000 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Such payment shall be:

(A) made by United States postal money order, certified check, bank cashier's check or bank money order;

(B) made payable to the Securities and Exchange Commission;

(C) hand-delivered or mailed to Enterprise Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, AMZ-341, 6500 South MacArthur Boulevard, Oklahoma City, OK 73169; and

(D) submitted under cover letter that identifies Petrovich as a Respondent in these proceedings, and the file number of these proceedings. A copy of the cover letter and money order or check shall be sent to Scott Friestad, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, D.C. 20549.

In determining whether to accept Petrovich's Offer, the Commission has considered this undertaking. Petrovich agrees that if the Division of Enforcement believes that Petrovich has not satisfied this undertaking, it may petition the Commission to reopen the matter to determine whether additional sanctions are appropriate.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in the Offer.

Accordingly, pursuant to Section 21C of the Exchange Act, it is hereby ORDERED that:

A. Petrovich cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A), and 13(b)(2)(B) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Aguilar
Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73754 / December 5, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-15045

In the Matter of **DAVID MURA,** **Respondent.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND ORDERING CONTINUATION OF PROCEEDINGS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest to enter this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Ordering Continuation of Proceedings against David Mura ("Respondent").[1]

II.

Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and

[1] On September 24, 2012, the Commission instituted public administrative and cease-and-desist proceedings pursuant to Sections 15(b) and 21C of the Exchange Act against Respondent.

the subject matter of these proceedings, which are admitted, and except as provided herein in Section VI, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Ordering Continuation of Proceedings ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

Summary

1. Mura violated Section 15(a) of the Exchange Act by acting as an unregistered broker-dealer in connection with his solicitation of investors in promissory notes (the "LLC Promissory Notes") issued by several small, related New York Limited Liability Companies (the "LLCs") located in Pittsford, New York.

2. While Mura engaged in these solicitation efforts, he was a registered representative and branch office manager of J.P. Turner & Company, LLC ("J.P. Turner"), a broker-dealer registered with the Commission. Despite his association with J.P. Turner, Mura conducted the offering of the LLC Promissory Notes outside the scope of his employment with J.P. Turner, in violation of Section 15(a) of the Exchange Act.

3. Mura also directed Edward Tackaberry ("Tackaberry"), who worked for the LLCs under Mura's supervision, and an investor in an LLC Promissory Note ("Investor 1") to solicit potential investors and to otherwise participate in the offering of the LLC Promissory Notes. Tackaberry and Investor 1 both followed Mura's instruction, and several individuals who were solicited by Tackaberry and/or Investor 1 eventually invested in the LLC Promissory Notes. Through these actions, Tackaberry and Investor 1 violated Section 15(a) of the Exchange Act, and Mura aided and abetted and caused Tackaberry's and Investor 1's violations of Section 15(a) of the Exchange Act.

Respondent

4. Mura is 65 years old and a resident of Pittsford, New York. From September 2002 through April 2011, Mura was a registered representative and branch office manager of J.P. Turner, a registered broker-dealer headquartered in Atlanta, Georgia. From in or around mid-2007 through in or around 2012, Mura led a team of individuals that managed the LLCs, and directed, and participated in, an effort to solicit investors in the LLC Promissory Notes. During this time, no offerings of securities issued by the LLCs were registered with the Commission in any capacity.

Other Relevant Entities

5. Rising Storm Technologies LLC ("Rising Storm"), a predecessor to the LLCs, was formed in 2006 to pursue various business ideas. Mura invested in Rising Storm and, in or around 2008, caused the LLCs to take over some or all of Rising Storm's business ideas. The LLCs consist of, inter alia, Charge-On Demand LLC, Innovations Group Enterprises LLC, and Stucco LLC, all of which were registered with the New York Secretary of State in 2008. The LLCs were formed to pursue several supposedly entrepreneurial business ideas. The LLCs, which were all managed by the same small management team led by Mura, issued the LLC Promissory Notes to a number of investors from in or around January 2008 through in or around September 2009.

6. Edward Tackaberry, now deceased, was a resident of Fairport, New York. From 1981 through 2006, Tackaberry was a registered representative of various broker-dealers. In September 2007, Tackaberry was barred from association with any broker or dealer based on permanent injunctions imposed by a federal district court upon finding, in a case brought by the Commission, that he committed securities fraud in a scheme that did not involve the LLCs. (In the Matter of Mark Palazzo and Edward Tackaberry, Admin. Proc. File No. 3-12844, Exchange Act Release No. 56550A (September 27, 2007); SEC v. Pittsford Capital Income Partners, L.L.C., 06 Civ. 6353 T(P) (W.D.N.Y. Aug. 30, 2007)). Tackaberry began working for Rising Storm in 2006 as a product salesman, and at Mura's direction, thereafter became involved in the solicitation of investors and otherwise participated in the offering of the LLC Promissory Notes.

Mura's Violations of Registration Provisions under the Exchange Act

7. From September 2002 through April 2011, Mura was a registered representative and branch office manager of J.P. Turner. In or around 2006, Mura became familiar with Rising Storm when he leased to Rising Storm vacant office space that was adjacent to Mura's J.P. Turner office. Mura and two or more of his retail broker-dealer customers at J.P. Turner invested in Rising Storm.

8. In 2008, Mura formed, or caused to be formed, the LLCs, for the purpose of commercializing several of Rising Storm's most promising business ideas and to pursue various, purportedly entrepreneurial, business ideas of their own. Shortly thereafter, Mura ousted the founder of Rising Storm, who also participated in the management of the LLCs, and installed his own management team to help run the LLCs. Mura accomplished this ouster through coercion. Mura oversaw all important decisions and exercised ultimate managerial control over the LLCs from approximately 2008 through 2012.

9. From in or around January 2008 through September 2009, Mura solicited a number of individuals to invest in the LLCs. More specifically, Mura led meetings with potential investors in the LLCs during which he made many oral representations regarding the LLCs and their operations, what an investment in the LLCs would involve and how it would be documented, and encouraged potential investors to invest in the LLCs by purchasing the LLC Promissory Notes, which are securities under the federal securities laws. No private placement

memoranda or other comprehensive offering materials were prepared or distributed to potential investors in connection with the offering. Mura told most, or all, of the prospective investors that he worked full-time as a financial professional and was a registered representative of J.P. Turner.

10. Mura also directed others to solicit potential investors in the LLC Promissory Notes. For example, after Investor 1 invested in an LLC Promissory Note, Mura encouraged him to solicit other investors, and Mura agreed that the LLCs would pay Investor 1 a finder's fee of 7.5% of all investments made by Investor 1's friends and family. Several individuals identified by Investor 1 decided to, and did, invest in the LLC Promissory Notes after discussing the potential investment with Investor 1, Mura, and others. Mura also directed Tackaberry to become involved in the solicitation of investors in the LLCs. Tackaberry did so by serving as several prospective investors' first contact at the LLCs, describing the investments and how they would be documented, arranging meetings with Mura and other members of the LLCs' management team to discuss the LLCs and the potential investment, negotiating the terms of investment with some of the investors, and documenting several investment transactions.

11. During the relevant period, in exchange for their investments, investors received LLC Promissory Notes, the offering of which was not registered with the Commission. The LLC Promissory Notes obligated the issuing LLC to repay the principal in twenty-four months plus 8% interest per annum. The LLC Promissory Notes also entitled the investors to "further consideration" consisting of a stated percentage of the issuing LLC's profits. In almost all cases, the LLC Promissory Notes were issued by just one of the LLCs, although the specific LLC issuing a given promissory note changed over time. The LLCs did not make interest payments to the investors, contrary to the terms of the LLC Promissory Notes.

12. In or around 2010, Mura persuaded most investors to exchange their purported interests in the LLCs for an interest in Worldwide Medical LLC ("Worldwide Medical"). Worldwide Medical does not have significant assets or revenues, and the investors' interests in Worldwide Medical are worth far less than the principal they initially invested in the LLC Promissory Notes.

13. In the aggregate, at least seventeen individuals invested over $850,000 in Rising Storm and the LLCs between July 2007 and September 2009. Mura played an active role in soliciting approximately $765,000 from approximately twelve of these investors after he took over the LLCs. At least seven of these twelve investors invested all, or a significant portion of, their qualified retirement accounts in the LLCs.

14. Mura caused investor funds to be deposited into the LLCs' bank accounts, over which Mura and his wife had authority, and against which Mura and his wife regularly issued checks. Mura caused the LLCs to pay him more than $50,000 from June 2008 through December 2009. These payments were made with funds that had been received from investors.

15. Mura conducted the LLC Promissory Note offering outside the scope of his employment with J.P. Turner. Mura did not place the LLC Promissory Notes in J.P. Turner accounts on behalf of the investors, and did not disclose to J.P. Turner his solicitation of these investments or the scope of his managerial role at the LLCs. Nor did Mura separately register as a broker-dealer for purposes of offering and selling the LLC Promissory Notes. Moreover, Mura repeatedly misled J.P. Turner about his outside business activities.

Violations

16. As a result of the conduct described above, Respondent willfully violated Section 15(a)(1) of the Exchange Act, which makes it unlawful for any broker or dealer which is either a person other than a natural person or a natural person not associated with a broker or dealer which is a person other than a natural person (other than such a broker or dealer whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange) to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) unless such broker or dealer is registered in accordance with Section 15(b) of the Exchange Act.

17. Also as a result of the conduct described above, Respondent willfully aided and abetted and caused Tackaberry's and Investor 1's violations of Section 15(a)(1) of the Exchange Act.

IV.

Pursuant to this Order, Respondent agrees that additional proceedings are necessary to determine whether Respondent should be ordered to pay disgorgement pursuant to Section 21C(e) of the Exchange Act and penalties pursuant to Section 21B(a)(2) of the Exchange Act, and if so, the amount of such disgorgement and penalties he should be ordered to pay. In connection with such additional proceedings: (a) Respondent agrees that he will be precluded from arguing that he did not violate the federal securities laws described in this Order; (b) Respondent agrees that he may not challenge the validity of this Order; (c) solely for the purposes of such additional proceedings, the findings of this Order shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may determine the issues raised in the additional proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence.

V.

In view of the foregoing, the Commission deems it appropriate and in the public interest, and for the protection of investors to impose the sanctions agreed to in Respondent's offer and to continue the proceedings to determine whether Respondent should be ordered to pay disgorgement and penalties and, if so, the amount of such disgorgement and penalties.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act.

B. Respondent be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

C. Any reapplication for association by Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

IT IS FURTHER ORDERED, pursuant to Rule 100(c) of the Commission's Rules of Practice, 17 C.F.R. § 201.100(c), in the interest of justice and without prejudice to any party to the proceeding, that a public hearing for the purpose of taking evidence on whether Respondent should be ordered to pay disgorgement and penalties and, if so, the amount of such disgorgement and penalties may be convened at a time and place to be fixed by, and before, the Administrative Law Judge assigned to the proceedings instituted against David Mura on September 24, 2012.

If Mura fails to appear at a hearing after being duly notified, Mura may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 221(f), and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.221(f), and 201.310.

VI.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-73755; File Nos. SR-FICC-2014-810; SR-NSCC-2014-811; SR-DTC-2014-812)

December 5, 2014

Self-Regulatory Organizations; Fixed Income Clearing Corporation; National Securities Clearing Corporation; The Depository Trust Company; Notice of Filing of Advance Notices, as Amended, to Amend and Restate the Third Amended and Restated Shareholders Agreement, Dated as of December 7, 2005

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010[1] ("Clearing Supervision Act") and Rule 19b-4(n)(1)(i)[2] under the Securities Exchange Act of 1934, notice is hereby given that on November 5, 2014, Fixed Income Clearing Corporation ("FICC"), National Securities Clearing Corporation ("NSCC"), and The Depository Trust Company ("DTC," together with FICC and NSCC, "Operating Subsidiaries") filed with the Securities and Exchange Commission ("Commission") the advance notices SR-FICC-2014-810, SR-NSCC-2014-811 and SR-DTC-2014-812 ("Advance Notices"), respectively, as described in Items I and II below, which Items have been prepared primarily by the Operating Subsidiaries. On November 17, 2014, the Operating Subsidiaries each filed Amendments No. 1 to the Advance Notices.[3] On November 17, 2014 FICC withdrew Amendment No. 1 and filed Amendment No. 2 to

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1 12 U.S.C. 5465(e)(1).

2 17 CFR 240.19b-4(n)(1)(i).

3 NSCC and DTC filed Amendment Nos. 1 to provide additional description of the changes proposed in advance notices SR-NSCC-2014-811 and SR-DTC-2014-812, respectively.

advance notice SR-FICC-2014-810.[4] The Commission is publishing this notice to solicit comments on the Advance Notices, as amended, from interested persons.

I. Clearing Agencies' Statement of the Terms of Substance of the Advance Notices

The Advance Notices, as amended, were filed by the Operating Subsidiaries in connection with the amendment and restatement of the Third Amended and Restated Shareholders Agreement, dated as of December 7, 2005 ("Existing Shareholders Agreement"), by and among The Depository Trust & Clearing Corporation ("DTCC"), Operating Subsidiaries, and the other parties thereto (such Existing Shareholders Agreement as so proposed to be amended and restated, "Revised Shareholders Agreement"), as more fully described below.

II. Clearing Agencies' Statement of the Purpose of, and Statutory Basis for, the Advance Notices

In their filings with the Commission, the Operating Subsidiaries included statements concerning the purpose of and basis for the Advance Notices, as amended, and discussed any comments received on the Advance Notices, as amended. The text of these statements may be examined at the places specified in Item IV below. The Operating Subsidiaries have prepared summaries, set forth in sections (A) and (B) below, of the most significant aspects of these statements.

(A) Clearing Agencies' Statement on Comments on the Advance Notices Received from Members, Participants, or Others

Beginning in June 2014, DTCC has conducted outreach to users of the services and facilities of the Operating Subsidiaries in order to provide them with advance notice

4 FICC withdrew Amendment No. 1 to advance notice SR-FICC-2014-810 due to an error in filing the amendment. FICC filed Amendment No. 2 to advance notice SR-FICC-2014-810 in order to provide additional description of the changes proposed in the advance notice.

of the proposed changes and the impact on a firm-by-firm basis. The outreach efforts have included providing individual shareholder firms with statements of their projected potential impact. As of the date of this filing, no written comments relating to the proposed changes have been received in response to this outreach. The Commission will be notified of any written comments received.

(B) Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Description of Change

The Existing Shareholders Agreement is proposed to be amended to: (1) update and simplify the formulas used to allocate shares of the common stock of DTCC ("Common Shares") among users of the Operating Subsidiaries, which are DTCC's registered clearing agency subsidiaries, and to determine the purchase price of Common Shares for purposes of such allocations and other transfers of Common Shares; (2) provide for the requirement to purchase newly-issued Common Shares by holders of Common Shares ("Common Share Holders") that are required to purchase and own Common Shares ("Mandatory Share Holders"), subject to the approval of Mandatory Share Holders holding two-thirds of all Common Shares held by Mandatory Share Holders; (3) provide for the repurchase of Common Shares from Mandatory Share Holders by DTCC, in an aggregate amount up to the aggregate amount of all newly-issued Common Shares purchased by Mandatory Share Holders; (4) provide for the reallocation of entitlements to own Common Shares at least once every three calendar years, but not otherwise limiting the frequency of such reallocation; and (5) make other conforming and technical changes as described below and as shown on Exhibit 3 to this filing.[5] Common Share Holders which are permitted but not required to purchase and own Common Shares ("Voluntary Share Holders") would not be required to purchase any newly-issued Common Shares or to sell any Common Shares to DTCC in connection with such a repurchase.

The proposed changes to the Existing Shareholders Agreement are the product of a comprehensive review by DTCC of its ownership, governance and capital structure, undertaken for the purposes of increasing the financial resources available to support the conduct of the businesses of the Operating Subsidiaries and enhancing regulatory risk management.[6] The proposed amendments are subject to the non-objection of the Commission to the Advance Notices as well as the consent of the Common Share Holders.

Existing Shareholders Agreement. Pursuant to the Existing Shareholders Agreement and the rules of each of the Operating Subsidiaries,[7] certain members and participants are required to be Mandatory Share Holders and parties to the Existing

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5 Commission notes that Exhibit 3 to the Advance Notices was filed confidentially by the Operating Subsidiaries and is not attached to this notice.

6 On July 18, 2012, the Financial Stability Oversight Council ("FSOC") designated each of the Operating Subsidiaries a systemically important financial market utility under Title VIII of the Clearing Supervision Act. See FSOC 2012 Annual Report, Appendix A, available at http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf. Therefore, each of the Operating Subsidiaries is required to comply with the enhanced regulatory supervision and risk-management requirements under the Clearing Supervision Act.

7 See DTC Rule 31 (DTCC Shareholders Agreement); NSCC Rule 64 (DTCC Shareholders Agreement); Mortgage-Backed Securities Division of FICC ("MBSD") Rule 39 (DTCC Shareholders Agreement); and Government Securities Division of FICC ("GSD") Rule 49 (DTCC Shareholders Agreement), available at http://dtcc.com/legal/rules-and-procedures.aspx.

Shareholders Agreement; certain members and participants are permitted, but not required, to be Voluntary Share Holders and parties to the Existing Shareholders Agreement; and certain members and participants are not permitted to purchase and own Common Shares or become parties to the Existing Shareholders Agreement.

Section 2.01 of the Existing Shareholders Agreement provides for the periodic reallocation of Common Shares in order to accommodate changes in the users of the Operating Subsidiaries and changes in the users' use of the services and facilities of the Operating Subsidiaries. Entitlements to purchase and own Common Shares are reallocated no more frequently than once a year and no less frequently than once every three years. Such a reallocation is, in every case, based on relative use of the services and facilities of the Operating Subsidiaries over the period since the last reallocation.[8] In each reallocation, users (whether or not they are already Common Share Holders) that are permitted but not required to purchase and own Common Shares ("Voluntary Purchaser Participants") may purchase Common Shares in amounts commensurate with their use of the services and facilities of the Operating Subsidiaries. Users (whether or not they are already Common Share Holders) that are required to purchase and own Common Shares ("Mandatory Purchaser Participants") must purchase and own Common Shares in amounts (i) commensurate with their use of the services and facilities of the Operating Subsidiaries plus (ii) a pro-rata amount of any Common Shares that Voluntary Purchaser Participants have a right to purchase but do not elect to purchase. In each reallocation, each Common Share Holder (whether a Voluntary Purchaser Participant or a Mandatory

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8 Additionally, and separately from the periodic reallocation, Common Shares are redistributed from time to time to Common Share Holders pursuant to Section 2.02 of the Existing Shareholders Agreement as a result of member retirements.

Purchaser Participant) that owns more Common Shares than its share entitlement has the obligation to sell its excess Common Shares so that such Common Shares may be reallocated to Voluntary Purchaser Participants that elect to purchase Common Shares and Mandatory Purchaser Participants that are required to purchase Common Shares, in accordance with their entitlements.

Under the Existing Shareholders Agreement, the formula used to calculate entitlements for this periodic reallocation of Common Shares takes into account fees paid to the Operating Subsidiaries, as well as the average market value of securities held in custody at DTC (referred to as "DTC long positions") by the applicable user, in each case, over the relevant reallocation period. Additionally, the purchase price of each Common Share, which is calculated annually, is determined by a formula based on the book value of DTCC less a portion of the retained earnings of the Operating Subsidiaries.

The Existing Shareholders Agreement further provides that Common Share Holders have the right to elect all of the directors of DTCC (other than two directors elected by the holders of the shares of existing preferred stock of DTCC), and to vote on all other matters on which shareholders are entitled to vote. The Existing Shareholders Agreement further provides that a person elected as a director of DTCC also serves as a director of each of the Operating Subsidiaries, coordinating governance of DTC, NSCC, and FICC with their parent company, DTCC.

Proposed Amendments to the Existing Shareholders Agreement. The Revised Shareholders Agreement would: (1) remove the DTC long positions from the formula used to determine the allocation of entitlements to purchase Common Shares; (2) revise the formula for determining the purchase price of Common Shares to reflect the tangible book value of DTCC and eliminate any deduction of the retained earnings of the Operating Subsidiaries; (3) provide for the purchase of newly-issued Common Shares by Mandatory Share Holders, subject to the approval of Mandatory Share Holders holding two-thirds of all outstanding Common Shares held by Mandatory Share Holders; (4) provide for the repurchase of Common Shares from Mandatory Share Holders by DTCC, in an aggregate amount up to the aggregate amount of all newly-issued Common Shares purchased by Mandatory Share Holders; (5) provide for the reallocation of entitlements to own Common Shares at least once every three calendar years, but not otherwise limiting the frequency of such reallocation; and (6) make other conforming and technical changes as described below and as shown on Exhibit 3 to this filing.

(1) Update Common Share Allocation Formula

The formula used to periodically reallocate entitlements to purchase Common Shares, defined in Section 1.01 of the Existing Shareholders Agreement as the "Common Share Amount," is historical and, in the view of DTCC, no longer an appropriate measure of use of the Operating Subsidiaries.

The Common Share Amount calculation was based on the Shareholders Agreement of DTC, which was in effect before DTC became a subsidiary of DTCC in 1999. It was adopted to balance the interests of custodian banks with other types of users of DTC, including broker-dealers, that did not hold securities inventory at DTC but paid transactional fees for services. The current formula provides that (i) 80% of the entitlement to purchase Common Shares is based on the amount of fees paid by a user to the Operating Subsidiaries during the period starting on the first day of the calendar year in which the previous allocation was made and ending on the last day of the calendar year preceding the calendar year in which the allocation is to be made ("Allocation Period"), and (ii) the remaining 20% of the entitlement is based on the average market value of all securities credited to the DTC account of that user, *i.e.*, its DTC long positions, as of the end of the last business day of each month during the Allocation Period.

Today, all users of the three Operating Subsidiaries pay fees to one or more of the Operating Subsidiaries based on usage of the services and facilities of the Operating Subsidiaries, including fees for DTC long positions. Accordingly, DTCC has determined that it is no longer appropriate to factor into the calculation of share entitlements both the market value of DTC long positions and fees paid to DTC in respect of such DTC long positions. The Revised Shareholders Agreement would update the formula used to periodically reallocate entitlements to purchase Common Shares, defined in Section 1.01 of the Revised Shareholders Agreement as the "Common Share Allocation Amount," to eliminate the market value of DTC long positions, so that the formula would be based solely on fees paid to the Operating Subsidiaries.

Both the composition of users of the Operating Subsidiaries as well as the users' use of the services and facilities of the Operating Subsidiaries have changed over time, and today the consistent metric for measuring such use across the Operating Subsidiaries is fees paid. Therefore, and in order to ensure that the allocations of entitlements to purchase Common Shares continue to be proportionate to the use of the Operating Subsidiaries, DTCC is proposing to update the formula by removing the market value of DTC long positions, and basing the allocations entirely on fees paid to the Operating Subsidiaries. While custodian banks with securities holdings at DTC may be entitled (and required) to purchase fewer Common Shares as a result of this proposal, those

Common Shares would be re-allocated to other Common Share Holders proportionally. The proposal would adjust the overall shareholding of Common Shares so that it is based on a uniform metric across the Operating Subsidiaries that is representative of the current use of the Operating Subsidiaries.

(2) Amendment of Common Share Price Formula

As described below, two amendments are proposed to the formula for the purchase price of Common Shares. First, the deduction of a portion of retained earnings, a vestige of the historical development of DTCC, would be eliminated. Second, instead of full book value, the basis of the revised formula would be the tangible book value of DTCC. With these changes, the value of Common Shares for purchases, sales, and transfers should more closely reflect the liquidation value of the enterprise.

Under Section 1.01 of the Existing Shareholders Agreement, the price of Common Shares, the "Common Share Price," is defined by a formula that excludes a portion of the retained earnings of the Operating Subsidiaries from DTCC's book value. The Common Share Price is the price used (i) in connection with purchases and sales of Common Shares among Voluntary Purchaser Participants and Mandatory Purchaser Participants in the periodic reallocation of Common Shares and (ii) in connection with the transfer of the Common Shares of retiring or disqualified Common Share Holders. The Revised Shareholders Agreement would replace the formula contained in the Existing Shareholders Agreement with a formula designed to reflect the tangible book value of DTCC, *i.e.*, the full book value of DTCC less intangible items of book value (goodwill and intangible assets) and the liquidation preference of the preferred stock of DTCC.[9]

When DTC and NSCC became subsidiaries of DTCC, the DTC shareholders who were DTC participants exchanged their DTC shares for DTCC Common Shares and became Common Share Holders. At that time, no members of NSCC ("NSCC Members") were NSCC shareholders, so no NSCC Members became Common Share Holders. NSCC Members were first given the opportunity to purchase Common Shares in the year 2000 share reallocation. It was considered unfair double-counting for NSCC Members to purchase DTCC Common Shares in that share reallocation at a price augmented by the retained earnings of NSCC. For this reason, the retained earnings of NSCC were deducted from DTCC's book value in determining the price of Common Shares. When Government Securities Clearing Corporation and MBS Clearing Corporation (later merged to become FICC) became subsidiaries of DTCC in 2002, this construct was continued. Under the Existing Shareholders Agreement, the price of Common Shares is determined by deducting the aggregate amount of the retained earnings of each of the Operating Subsidiaries (although the deduction of DTC retained earnings is limited to $24,007,000, an amount representing the retained earnings of DTC as of December 31, 2001) from the book value of the Common Shares as of December 31 of the preceding calendar year.

As stated, the deduction of the retained earnings of the Operating Subsidiaries in this formula was intended to be a one-time adjustment to address unfairness to the

9 Intangible items of book value used in this calculation, *i.e.*, goodwill and intangible assets, are shown on DTCC's Consolidated Statement of Financial Condition, which is available on the DTCC website at http://dtcc.com/legal/financial-statements.aspx.

participants of the Operating Subsidiaries that was tied to the corporate transactions through which each Operating Subsidiary was integrated into the DTCC family. Therefore, with the passage of time and the turnover in participants, the deduction no longer serves this historical purpose, or any purpose, in the reallocations of entitlements to purchase Common Shares that occurred after the integration of the Operating Subsidiaries. The proposed change is a part of the effort to update the Existing Shareholders Agreement.

In the Revised Shareholders Agreement, the formula for the purchase price of Common Shares would be based on the tangible book value of DTCC, a price that would more accurately represent the liquidation value of DTCC, and keep the price more stable and predictable over time. While the proposal may cause the purchase price of Common Shares to increase somewhat, it should not materially impair the ability of the members and participants of the Operating Subsidiaries to acquire Common Shares.

(3) <u>Raise Capital through the Issue and Sale of Newly-Issued Common Shares to Mandatory Share Holders</u>

In order to raise capital for business purposes, the Revised Shareholders Agreement would provide that DTCC may sell newly-issued Common Shares to Mandatory Share Holders on a mandatory basis. Proceeds of the sale of these newly-issued Common Shares would be contributed by DTCC to the Operating Subsidiaries as capital as needed so that the Operating Subsidiaries may continue to provide efficiently for the prompt and accurate clearance and settlement of securities transactions in U.S. securities markets. Each issuance and required purchase of Common Shares for this purpose would be subject to the approval of the Mandatory Share Holders holding two-thirds of all Common Shares held by Mandatory Share Holders. Voluntary Share

Holders would not be required or permitted to purchase these newly-issued Common Shares.

The Operating Subsidiaries require additional capital to support their business operations. Historically, they have operated on an *at-cost* or *near-cost* basis and rebated any excess revenues to users of their services. Recently, however, the Operating Subsidiaries have experienced a greater need to increase capital to meet higher operating costs and, as systemically important financial market utilities, to satisfy heightened risk management requirements. DTCC has performed extensive analyses to determine these needs, and has considered alternative means to address them. A principal objective is maintenance of sufficient, readily available, liquid net assets to allow the Operating Subsidiaries to meet current and projected operating requirements under a range of scenarios, including adverse market conditions. An increase in fees was deemed impractical because it would not necessarily generate sufficient resources in a reasonable time frame and depends on transactional volumes, which may be volatile. DTCC was also concerned with the financial burden that significant fee increases could place on users over an extended period.

As a user-owned and governed organization, DTCC does not have access to public markets to raise common equity. Accordingly, the Revised Shareholders Agreement would contain a mechanism to provide DTCC with the ability to raise capital by selling newly-issued Common Shares to Mandatory Share Holders on a mandatory basis, pro rata in accordance with their shareholdings at the time of such sale. As the principal users of the services and facilities of the Operating Subsidiaries, Mandatory Share Holders benefit directly from the critical clearance and settlement services provided by the Operating Subsidiaries. Importantly, the mechanism would only be exercised with the approval of Mandatory Share Holders holding two-thirds of all Common Shares held by Mandatory Share Holders. Therefore, the implementation of this mechanism for any particular amount of capital or number of Common Shares, at any time, would require a vote of the Mandatory Share Holders.

(4) <u>Mandatory Repurchase of Common Shares</u>

The Revised Shareholders Agreement would also provide a mechanism under which DTCC may repurchase Common Shares from Mandatory Share Holders on a mandatory basis in an aggregate amount up to the aggregate amount of all newly-issued Common Shares purchased by Mandatory Share Holders. This would be at the discretion of the DTCC Board of Directors (which includes all the same directors as the Boards of DTC, NSCC, and FICC), to allow flexibility to return funds to Mandatory Share Holders if the Operating Subsidiaries have capital in excess of their capital needs.

(5) <u>Frequency of Reallocation of Already-Issued Common Shares</u>

The Revised Shareholders Agreement would provide that the reallocation of entitlements to own already issued Common Shares may take place when determined by the DTCC Board of Directors, but no less frequently than once every three calendar years. While the Existing Shareholders Agreement restricts DTCC from performing this reallocation more frequently than once a year, the proposed change would remove this restriction in order to allow more frequent reallocations, when appropriate. Each reallocation aligns a Common Share Holder's entitlements to own already issued Common Shares with that firm's use of the Operating Subsidiaries. This update will permit these alignments to take place more frequently and ownership of Common Shares can be a more contemporaneous reflection usage.

(6) Other Conforming and Technical Amendments to the Existing Shareholders Agreement

The Revised Shareholders Agreement would also include certain other technical amendments, including conforming and clarifying changes, as reflected on Exhibit 3 to this filing. Among those changes is an amendment to the definition of "Common Share Amount" in Section 1.01 of the Existing Shareholders Agreement (called the "Common Share Allocation Amount" in the Revised Shareholders Agreement), to clarify that the calculation does not include any fees that are pass-through fees, *i.e.*, amounts collected by an Operating Subsidiary for the account of a third party and paid by that Operating Subsidiary to a third party.

The definition of "Settlement" in Section 1.01 of the Existing Shareholders Agreement will also be amended to move the time at which settlement is effected from 5:00 p.m. New York City Time on the Settlement Date, as such terms are defined in the Existing Shareholders Agreement, to 4:00 p.m. New York City Time on the Settlement Date. This is an operational change in order to align Common Share settlement times with the routine times of end of day settlement for each of the Operating Subsidiaries.

A further clarifying amendment would include members of MBSD, other than Cash-Settling Bank Members (as such term is defined in the Rules of MBSD), within the definition of "Mandatory Purchaser Participants." As a result of the Commission's approval in 2012 of FICC becoming a central counterparty for transactions processed and cleared at its mortgage-backed securities division, the change would apply to the users of

MBSD the general rule that full service members, including users of guaranteed services, of an Operating Subsidiary are Mandatory Purchaser Participants.

The Revised Shareholders Agreement would also amend the definition of "Qualified Person," which sets forth the types of entities that may hold Common Shares, to exclude: (1) Federal Reserve Banks, because it was never intended that such governmental authorities should be required to own shares in DTCC, notwithstanding that they may use certain services of the Operating Subsidiaries; (2) central counterparties or central securities depositories, because these link arrangements are for the purpose of extending clearing agency services across borders or among closely related activities and products but not for ownership purposes; and (3) any other financial market infrastructure or utility that the DTCC Board of Directors determines shall not be a "Qualified Person." The Revised Shareholders Agreement would also update the definition of "Deliver" to include more convenient and contemporary methods of delivering notices, for example, by electronic mail where appropriate. Finally, Section 2.02 is proposed to be updated regarding the transfer of Common Shares in the event that a Common Share Holder is no longer a Qualified Person, to provide that the pro-rata re-distribution of those Common Shares to all other Common Share Holders take place at the beginning of the following calendar year rather than contemporaneously with such Common Share Holder ceasing to be a Qualified Person, as provided in the Existing Shareholders Agreement. This change reflects current practice and is more practical, administratively.

Anticipated Effect on and Management of Risk

The DTCC Board of Directors unanimously approved the proposed amendments described in this filing. In evaluating these proposals, the Board carefully considered the expectations and obligations that are imposed on the Operating Subsidiaries as systemically important financial market utilities in the national system for clearance and settlement of securities transactions. The proposed changes would reduce the risks presented by the Operating Subsidiaries. The proposed change to the formula used to reallocate entitlements to purchase Common Shares would bring this methodology up to date so that the allocation accurately reflects the use of the services and facilities of the Operating Subsidiaries. The proposal to update the formula used to determine the price of Common Shares would provide an updated pricing approach, eliminating historical adjustments that are no longer relevant and providing a price based on tangible book value. The proposal to provide for the issuance of additional Common Shares by DTCC, subject to shareholder approval, for required purchase by Mandatory Share Holders, would provide a necessary source of capital for the protection of the Operating Subsidiaries, their members, and the financial markets in which they operate. The proposal also includes a mechanism under which DTCC may repurchase Common Shares from Mandatory Share Holders on a mandatory basis, at the discretion of the DTCC Board of Directors, so that funds may be returned to Mandatory Share Holders that furnished additional capital through this mechanism, for example, if, and when, there is excess capital.

Section 805(b) of the Clearing Supervision Act states that the objectives and principles for the risk management standards prescribed under Section 805(a) shall be to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.[10] The proposal represents a fair

[10] 12 U.S.C. 5461(a), (b).

and appropriate apportionment of the business risks of the Operating Subsidiaries among their users, and would allow DTCC to raise capital for the Operating Subsidiaries in order to continue to carry on their businesses in an efficient and effective manner, thereby promoting safety and soundness of the operations of the Operating Subsidiaries, reducing their general business risks as well as systemic risk, and supporting stability in the U.S. securities markets and the broader financial system. Additionally, the provision for DTCC, subject to Mandatory Share Holder approval, to sell newly-issued Common Shares to Mandatory Share Holders is critical to the capitalization of the Operating Subsidiaries. Maintenance of adequate financial resources is a key element in reducing systemic risk, and serves to limit the contagion that could flow from an isolated disruption to the wider financial markets. In this way, the proposal to raise capital would also reduce systemic risk and serves to promote the prompt and accurate clearance and settlement of securities transactions and the protection of investors, particularly in times of market stress or crisis. The proposed provision that would allow for the repurchase of Common Shares from Mandatory Share Holders at the discretion of the DTCC Board of Directors protects Mandatory Share Holders by returning funds to those firms, for example, if, and when, there is excess capital.

Finally, the proposal to allow DTCC to reallocate entitlements to own Common Shares more frequently than once every year allows DTCC to align ownership of Common Shares with Common Share Holders' usage of the Operating Subsidiaries on a more contemporaneous basis, when appropriate. This proposed change reduces the risk that Common Share Holders own Common Shares that are no longer proportionate to their current use of the Operating Subsidiaries.

Implementation Timeframe. The Revised Shareholders Agreement would become effective (1) upon the approval of the Common Share Holders; and (2) if the Commission does not object to the Advance Notices within 60 days of the later of (i) the date the Commission receives the Advance Notices, or (ii) the date the Commission receives any further information it requests for consideration of the Advance Notices.

III. Date of Effectiveness of the Advance Notices, and Timing for Commission Action

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date that the proposed change was filed with the Commission or (ii) the date that any additional information requested by the Commission is received. The Operating Subsidiaries shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing the Operating Subsidiaries with prompt written notice of the extension. A proposed change may be implemented in less than 60 days from the date the Advance Notices were filed, or the date further information requested by the Commission is received, if the Commission notifies the Operating Subsidiaries in writing that it does not object to the proposed change and authorizes the Operating Subsidiaries to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

The Operating Subsidiaries shall post notice on DTCC's website of proposed changes that are implemented.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the Advance Notices are consistent with the Clearing Supervision Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-FICC-2014-810, SR-NSCC-2014-811 or SR-DTC-2014-812 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-FICC-2014-810, SR-NSCC-2014-811 or SR-DTC-2014-812. One of these file numbers should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the Advance Notices that are filed with the Commission, and all written communications relating to the Advance Notices between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public

Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of the Operating Subsidiaries and on DTCC's website at http://dtcc.com/legal/sec-rule-filings.aspx. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FICC-2014-810, SR-NSCC-2014-811 or SR-DTC-2014-812 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES EXCHANGE ACT OF 1934
Release No. 73763 / December 5, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3602 / December 5, 2014

Admin. Proc. File No. 3-15012

In the Matter of

S.W. HATFIELD, CPA and
SCOTT W. HATFIELD, CPA

OPINION OF THE COMMISSION

RULE 102(e) PROCEEDING

CEASE-AND-DESIST PROCEEDING

Ground for Remedial Action

Fraud

Accounting firm and its sole proprietor willfully violated the antifraud provisions of the federal securities laws by issuing false audit reports. *Held*, it is in the public interest to permanently deny respondents the privilege of appearing or practicing before the Commission as accountants, impose a cease-and-desist order, order disgorgement of $112,529, plus prejudgment interest, and assess a $110,500 civil penalty.

APPEARANCES:

Scott W. Hatfield, CPA, pro se and for S.W. Hatfield, CPA.

David B. Reece and *Jessica B. Magee*, for the Division of Enforcement.

Appeal filed: October 1, 2013
Last brief received: April 14, 2014

The Division of Enforcement appeals from the decision of an administrative law judge dismissing a proceeding brought pursuant to Sections 4C(a)(1) and (3), 21B, and 21C of the Securities Exchange Act of 1934 and Rule 102(e)(1)(i) and (iii) of the Commission's Rules of Practice and based on allegations that Respondents willfully violated the antifraud provisions of the federal securities laws.[1] The law judge found that the Division failed to allege that S.W. Hatfield, CPA ("the Firm"), a Texas accounting firm, and Scott W. Hatfield, the Firm's sole proprietor (together, "Respondents"), made misrepresentations with respect to certain audit reports that Respondents issued while the Firm was not in possession of a state license to do so. Accordingly, the law judge found that there was no basis for sanctioning Respondents.

We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal. We find that the legal conclusions on which the law judge based her dismissal were incorrect. We further find that the Division met its burden under Rule of Practice 250 to show that "there is no genuine issue with regard to any material fact" and that it "is entitled to a summary disposition as a matter of law."[2] We find that Respondents willfully violated the antifraud provisions and that certain sanctions are in the public interest.

I. Background

A. Respondents issued thirty-eight audit reports for twenty-one public company issuers while the Firm was not licensed by the State of Texas.

The underlying facts are largely undisputed. Hatfield has been licensed by the Texas State Board of Public Accountancy ("TSBPA") as a certified public accountant ("CPA") since 1985. He is the Firm's sole officer, director, and accountant. The Firm has been licensed by the TSBPA as a CPA firm since 1994, and Hatfield renewed the Firm's license annually through January 2009. At the relevant times, the Firm also was registered with the Public Company Accounting Oversight Board ("PCAOB").

In a letter dated October 9, 2009, the TSBPA notified Respondents that the Firm's license for 2010 would not be issued because the Firm had failed to report peer review results as required by the TSBPA's Peer Review Program.[3] The letter instructed Hatfield to complete and submit an "Affidavit for Exemption from Peer Review" if he believed that the Firm was exempt from undergoing a peer review. If, for example, a CPA firm has issuer clients only, the firm can

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1 15 U.S.C. §§ 78d-3(a)(1) and (a)(3), 78u-2, 78u-3; 17 C.F.R. § 201.102(e)(1)(i) and (iii).

2 17 C.F.R. § 201.250.

3 *See* TEX. ADMIN. CODE § 515.3(b)(4) ("If a firm is subject to peer review, then a firm's office license shall not be renewed unless the office has met the peer review requirements as defined in Chapter 527 of this title" (relating to Peer Review)). The Peer Review Program monitors firms' compliance with applicable accounting, auditing, and other attestation standards adopted by generally recognized standard-setting bodies. The program includes education, remediation, disciplinary sanctions, or other corrective action when a firm is not in compliance. TEX. ADMIN. CODE § 527.1.

claim an exemption and instead satisfy the peer review requirement by having the PCAOB conduct an inspection and provide a report to the TSBPA stating that the peer review had been completed. Although Respondents claim the Firm had only issuer clients, they did not submit such an affidavit. In fact, the PCAOB had been investigating Respondents since 2008, and Respondents could not provide the TSBPA with the requisite assurances that the PCAOB inspection process had been completed. Hatfield did not claim any exemption. By the end of 2009, the TSBPA notified Respondents in writing that the Firm's license would expire on January 31, 2010.

On March 8, 2010, the TSBPA sent an e-mail to Ronald Johnson, a Firm affiliate, stating that the Firm's license was delinquent and expired. On that same date, Johnson forwarded that e-mail to Hatfield at his e-mail address on file with the TSBPA, asking "What is up with this?" At about the same time, a TSBPA attorney informed Respondents' attorney by telephone that the Firm's license was expired, the Firm was three years delinquent in satisfying peer review requirements, and Respondents could be sanctioned for providing attest services without a valid license.[4] The TSBPA sent a letter to Respondents' attorney on March 15, 2010, stating that because it had recently learned that the Firm had issuer clients only, the Firm could satisfy its peer review by having the PCAOB inspect the Firm, and that the TSBPA would need to "receive a letter from PCAOB stating that all issues have been 'Satisfactorily Addressed' by the firm." In a letter dated July 8, 2010, the TSBPA again advised Respondents' counsel that the Firm could not hold itself out as a CPA firm or perform audits or attestations because its license was delinquent and expired. In May 2011, the TSBPA permitted the Firm to renew its license.

From January 31, 2010 until May 19, 2011, the period during which the Firm's license was expired ("the Relevant Period"), Respondents issued thirty-eight audit reports for twenty-one public company issuers. Each audit report was issued on letterhead titled, "S.W. Hatfield, CPA," and was signed by Hatfield on behalf of the Firm as "S.W. Hatfield, CPA." The audit reports were included, with Respondents' authorization, in the issuers' periodic reports and registration statements filed with the Commission.[5] Respondents charged approximately $200,000 in fees for audits conducted or completed while the Firm was not in possession of a valid license.

B. The Commission instituted proceedings.

On September 6, 2012, the Commission issued a Corrected Order Instituting Proceedings ("OIP") alleging that Respondents willfully violated Exchange Act Section 10(b) and Rule 10b-5

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4 Attest services include issuing audit reports. TEX. OCC. CODE § 901.002(a)(1).

5 We take official notice of the twenty-one issuers' thirty-eight periodic reports and registration statements cited in this opinion pursuant to Rule 323. 17 C.F.R. § 201.323.

thereunder[6] and did not possess the requisite qualifications to represent others.[7] The OIP authorized, if appropriate, the imposition of sanctions under Exchange Act Section 4C(a)(1) and (3) and Rule 102(e)(1)(i) and (iii); and Exchange Act Sections 21B and 21C. The Division moved for summary disposition pursuant to Rule of Practice 250.

In dismissing the proceeding, the law judge found that the Firm was not licensed during the Relevant Period. The law judge determined that because the Firm was unlicensed when it issued the thirty-eight audit reports, the reports were signed by a CPA that was "not state-licensed and in good standing" contrary to the requirements of Regulation S-X. Accordingly, the law judge concluded that "the issuers who included [the Firm]'s audit reports with their filings violated the Exchange Act and Securities Act reporting provisions, and Hatfield and [the Firm] were secondarily liable for [those] violations" (which were not charged in the OIP). But the law judge also determined that "there is no allegation that the audit reports or the financial statements that were the subject of the audit reports contained misrepresentations, much less that Respondents were in any way liable for misrepresentations in the reports and financial statements." The law judge concluded that the "the allegation that Respondents violated Exchange Act Section 10(b) and Rule 10b-5 is unproven."

The law judge found that there was "no basis for sanctioning Respondents pursuant to Rule 102(e)(1)(iii)" in light of her determination that the Division failed to allege that Respondents made misrepresentations.[8] The law judge also found that there was no basis for sanctioning Respondents under Rule 102(e)(1)(i) because, "[t]o the extent that Rule 102(e)(1)(i) is referenced in any litigated case, it is associated with Rule 102(e)(1)(iii) and a respondent's having willfully violated the federal securities laws. There is no litigated case in which a respondent was sanctioned pursuant to Rule 102(e)(1)(i) alone." This appeal followed.

II. The Law Judge's Dismissal Was Improper.

Rule 250(a) permits a law judge to consider and rule on a motion for summary disposition at any time after a respondent files an answer and the Division has made its documents available to that respondent for inspection and copying.[9] A law judge may grant a motion for summary disposition if there is no genuine issue with regard to any material fact and the party making the motion is entitled to a summary disposition as a matter of law.[10] Where the Division is the moving party and the law judge determines that the Division has not met the

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6 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5.

7 The OIP was reissued in November 2012 to correct a clerical error.

8 The law judge did not mention Exchange Act Section 21B or 21C in reaching her disposition, but, without a finding that Respondents violated or were a cause of any securities laws violations, there would be no basis for sanctions under those provisions either.

9 17 C.F.R. § 201.250(a); *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 WL 367635, at *10 (Feb. 13, 2009).

10 17 C.F.R. § 201.250(b); *Kornman*, 2009 WL 367635, at *11.

standard for summary disposition under Rule 250, and where a respondent has not filed its own Rule 250 motion, our rules make no express provision for the law judge to sua sponte dismiss the proceeding without a hearing, as the law judge did here. Rather, the language of Rule 250(b) directing the law judge to either grant or deny the motion, together with language in the OIP ordering "that a public hearing for the purpose of taking evidence on the questions set forth in [the OIP] shall be convened" suggests that, in the circumstances here, a law judge's only alternative to granting the motion is to deny it and proceed with a hearing. At the very least, if a law judge concludes that it may be necessary to summarily dismiss a proceeding as a matter of law, the parties should be provided notice and an opportunity to be heard as to the possible basis for such a disposition.[11] Here, the Division had no notice either from the law judge, or through any arguments made by Respondents, that its case might be dismissed on the grounds that it failed to allege that Respondents made a misrepresentation.

On this record, we do not find it necessary to remand to the law judge for a hearing. The record before us supports our conclusion that the law judge's dismissal was incorrect as a matter of law and, further, that the Division has met its burden under Rule 250.[12] Contrary to the

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[11] Although we are not governed by the Federal Rules of Civil Procedure, those rules sometimes provide helpful guidance. *See Robert M. Ryerson*, Exchange Act Release No. 57839, 2008 WL 2117161, at *5 (May 20, 2008) ("Under certain circumstances, the Federal Rules of Civil Procedure provide helpful guidance, such as when issues are not directly addressed by our Rules of Practice.") (citation omitted). We note that a federal district court may respond to a motion for summary judgment by granting summary judgment sua sponte in a nonmoving party's favor, but only if the court provides the losing party with adequate notice about the issue ultimately decided against that party and an opportunity to address that issue. *See Celotex Corp. v. Catrett*, 477 U.S. 317, 326 (1986) (stating that "district courts are widely acknowledged to possess the power to enter summary judgments sua sponte, so long as the losing party was on notice that she had to come forward with all of her evidence"); *see also Advantage Consulting Grp., Ltd. v. ADT Sec. Sys., Inc.*, 306 F.3d 582, 588 (8th Cir. 2002) (finding that the district court did not err when it granted summary judgment sua sponte and stating that "[t]he court has inherent power to grant dispositive motions sua sponte so long as the losing party was on notice that she had to come forward with all of her evidence" (quoting *McClure v. Am. Family Mut. Ins. Co.*, 223 F.3d 845, 856 (8th Cir. 2000)); *Gibson v. Mayor & City Council of Wilmington*, 355 F.3d 215, 222-23 (3d Cir. 2004) (finding that, although there is authority for a court to grant summary judgment to the nonmoving party, a court should not do so without "first placing the adversarial party on notice that the court is considering a sua sponte summary judgment motion" and finding that notice means "that the targeted party had reason to believe the court might reach the issue and received a fair opportunity to put its best foot forward" (internal quotation marks omitted)); *Kassbaum v. Steppenwolf Prods., Inc.*, 236 F.3d 487, 494 (9th Cir. 2000) ("[I]f a court concludes that a non-moving party is entitled to judgment, great care must be exercised to assure that the original movant has had an adequate opportunity to show that there is a genuine issue and that his [or her] opponent is not entitled to judgment as a matter of law." (internal quotation marks omitted)).

[12] Where we have concluded that the record does not provide a basis for summary disposition, we have remanded for a hearing. *See Diane M. Keefe*, Exchange Act Release No.

(continued...)

conclusion in the Initial Decision, the Division did allege that the audit reports contained misrepresentations. The OIP alleges that Respondents knew they were not permitted to act as CPAs because the Firm's license had expired and that Hatfield nonetheless "knowingly signed the firm's name [as CPAs] to each audit report [the Firm] issued during the period [the Firm's] license was expired." In its brief in support of its motion for summary disposition, the Division devoted two pages to a discussion of these misrepresentations, stating specifically that "inclusion of an audit report issued by a person not recognized as an accountant is a material misstatement," along with citation to authority, and that "[i]mplicit in each of SWH's audit reports issued between January 31, 2010 and May 19, 2011 was the representation to each issuer that SWH was recognized as a CPA under the federal securities laws and qualified and permitted to issue audit reports on its clients' financial statements." Respondents' opposition to the Division's motion argued that the issuers, not they, actually made the alleged misrepresentations; that Hatfield's signature on the audit reports during the Relevant Period was not material due to the "technical and administrative" reason for their license having lapsed; and that because they purportedly made good-faith efforts to renew their license, they did not have the requisite scienter for fraud. We address, and reject, these arguments below, but the fact that Respondents made them demonstrates that they understood what misrepresentations they were alleged to have made.

The law judge also incorrectly concluded that Rule 102(e)(1)(i) cannot stand alone as a basis for sanctioning Respondents. The plain language separating the subparts of Rule 102(e)(1) uses the disjunctive "or," meaning that any one basis in the rule is sufficient to establish the Commission's authority to proceed. Such a reading is consistent with our previous determination that "Rule 102(e)(1) provides that a person may be denied the privilege of appearing or practicing before the Commission once the Commission makes *one* of three findings . . . ."[13] Whether all prior matters brought under Rule 102(e)(1)(i) also have been brought under Rule 102(e)(1)(iii) is not dispositive.

III. Respondents Willfully Violated Exchange Act Section 10(b) and Rule 10b-5(b) Thereunder.

To establish liability under Exchange Act Section 10(b) and Rule 10b-5(b) thereunder, the Division must show by a preponderance of the evidence that Respondents made a misrepresentation or omission, that such misrepresentation or omission was material, that the Respondents acted with scienter, and that the conduct was made in connection with the purchase

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61928, 2010 WL 1514182, at *2 (Apr. 16, 2010) (remanding for amplification of the record where the law judge decided the matter on summary disposition).

13 *Steven Altman, Esq.*, Exchange Act Release No. 63306, 2010 WL 5092725, at *15 n.50 (Nov. 10, 2010) (citing *Robert W. Armstrong, III*, Exchange Act Release No. 51920, 2005 WL 1498425, at *12 (June 24, 2005)) (emphasis added).

or sale of securities.[14] The Division also must show that Respondents' violations were willful to obtain relief under Exchange Act Section 4C(a)(3) and Rule 102(e)(1)(iii) and Exchange Act Section 21B(a)(1)(A). Because the law judge found that the Division did not allege misrepresentations, she did not address the parties' arguments regarding any of the other elements necessary to impose sanctions. We address those elements here.

A. Respondents made misrepresentations.

Under Commission rules, a signature on an audit report is a representation that the signer is a CPA. Exchange Act Section 13(a) requires that financial statements filed with the Commission be certified by a public accountant.[15] That certification occurs in the form of an audit report in which the CPA expresses an opinion about whether an issuer's financial statements fairly present the issuer's financial position in conformity with generally accepted accounting principles.[16] Under Rule 1-02(a) of Regulation S-X, an audit report must be prepared by a CPA.[17] Rule 2-01(a) of Regulation S-X provides that CPAs are only those accountants "duly registered and in good standing" in the jurisdiction in which they reside.[18] If a person issues an audit report as to a public issuer's financial statements, that person impliedly is stating that he is a CPA within the meaning of Regulation S-X. And if such person signs the audit report using the title CPA, that person is expressly stating that he is a CPA within the meaning of Regulation S-X.

From January 2010 until May 2011, when Respondents were not duly registered and in good standing in Texas, the jurisdiction in which they resided, they issued thirty-eight audit reports that were included in documents filed with the Commission pursuant to Regulation S-X by twenty-one issuers. As the Division argued, it was implicit in the filing of these audit reports that they were signed by a CPA because they were issued with issuers' financial statements filed pursuant to Regulation S-X. In fact, in the signature line and heading, Respondents explicitly represented that they were CPAs. The representations in the thirty-eight audit reports that Respondents were CPAs on the dates the reports were issued were false.

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14 *See* 15 U.S.C. § 78j(b); 17 C.F.R. § 240.10b-5(b); *Joseph John VanCook*, Exchange Act Release No. 61039, 2009 WL 4005083, at *8 (Nov. 20, 2009) (describing requirements for liability under antifraud provisions); *see also SEC v. Dain Rauscher, Inc.*, 254 F.3d 852, 855-56 (9th Cir. 2001) (noting that the antifraud provisions "forbid making a material misstatement or omission" in connection with the purchase or sale of securities); *SEC v. Brooks*, No. Civ. A. 3:99-CV-1326-D, 1999 WL 493052, at *2 (N.D. Tex. July 12, 1999).

15 15 U.S.C. § 78m.

16 17 C.F.R. § 210.2-02(c).

17 *Id.* at § 210.1-02(a)(1).

18 *Id.* at § 210.2-01(3)(a).

Respondents argue they did not make the alleged misrepresentations.[19] They argue that "because they did not have 'ultimate authority' over the statements, the Respondents were not makers of those statements for purposes of Section 10(b) and Rule 10b-5(b)," citing *Janus Capital Group, Inc. v. First Derivative Traders.*[20] *Janus* involved a private civil action alleging claims under Exchange Act Rule 10b-5 based on misrepresentations made in prospectuses filed with the Commission by Janus Investment Fund, a mutual fund company. The plaintiffs alleged that Janus Capital Management ("JCM"), the fund's investment adviser and administrator, committed fraud because it had been significantly involved in the creation of the misrepresentations.[21] The Court held that "the maker of a statement is the entity with authority over the content of the statement and whether and how to communicate it."[22] The Court found that "attribution within a statement or implicit from surrounding circumstances is strong evidence that a statement was made by—and only by—the party to whom it is attributed."[23] The Court found that JCM did not have ultimate control over the misrepresentations and therefore did not make the misrepresentations for purposes of Rule 10b-5.[24]

In stark contrast to the *Janus* facts, Respondents drafted, dated, printed on Firm letterhead, and signed thirty-eight audit reports that were included in documents filed with the Commission by twenty-one issuers. Under Regulation S-X, it is the CPA—and only the CPA—who has the authority over the content of the audit report and whether such audit report is issued

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19 Respondents have not filed any briefs or otherwise participated in the appeal before us. The Office of the Secretary notified Respondents in a letter dated June 26, 2014 that Respondents failed to file two briefs due in this appeal on December 23, 2013 and April 28, 2014, respectively. The letter noted that, on December 27, 2013, Respondents' counsel filed a Notice of Withdrawal as counsel and, in that notice, stated that it had sent Respondents all the pleadings in this matter, along with a copy of the notice. The letter explained that, pursuant to Rule 180(c), 17 C.F.R. § 201.180(c), the Commission may "decide the particular matter at issue against that person . . . if a person fails . . . to make a filing required under these Rules of Practice." The letter further explained that the Commission was deliberating and "could affirm, reverse and remand the proceeding to the law judge, or reverse and find against [Respondents] in a final order." Respondents were instructed to contact the Office of the Secretary if they intended to file any document in this matter, but they did not reply. Our discussion of Respondents' arguments is based on pleadings in their opposition to the Division's motion for summary disposition below.

20 131 S. Ct. 2296, 2302 (2011).

21 The plaintiffs also alleged that JCM had a close relationship with the fund, exercised significant influence over the fund and its prospectus disclosures, and was understood by investors to be the "maker" of disclosures issued by the fund.

22 131 S. Ct. at 2303.

23 *Id.* at 2302.

24 *Id.* at 2305.

for purposes of being included in an issuer's filing with the Commission.[25] Respondents were the purported CPAs who opined about the twenty-one issuers' financial statements and permitted those issuers to include the thirty-eight audit reports in their filings. Respondents thus were the makers of the misstatements.

B. Respondents' misrepresentations were material.

A fact is material if there is a substantial likelihood that a reasonable investor would have considered the misstated or omitted fact important in making an investment decision and if disclosure of the misstated or omitted fact would have significantly altered the total mix of information available to the investor.[26] "'The question of materiality, it is universally agreed, is an objective one, involving the significance of an omitted or misrepresented fact to a reasonable investor.'"[27]

Under the circumstances described above, the misrepresentation that audit reports appearing in registration statements and/or periodic reports filed with the Commission have been signed by a CPA is material. Respondents' audit reports appeared in registration statements and/or periodic reports filed with the Commission. Registration statements and periodic reports, specifically Forms 10-K, are two of the most common types of investor resources. An audit report signed by a CPA is important to investors because it provides an independent evaluation of the issuer's financial position by a qualified professional on whose expertise investors can rely. A reasonable investor would want to know that a purported CPA does not have a valid license when rendering an opinion about financial statements, especially when the reason for the license lapse calls into question whether the auditor currently complies with applicable professional standards.[28]

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25 Rule 1-02(a)(1) of Regulation S-X, 17 C.F.R. § 210.1-02(a)(1) (stating that "the term *accountant's report*, when used in regard to financial statements, means a document in which an independent public or certified public accountant indicates the scope of the audit (or examination) which he has made and sets forth his opinion regarding the financial statements taken as whole, or an assertion to the effect that an overall opinion cannot be expressed") (emphasis in original).

26 *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988); *TSC Indus. Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

27 *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 WL 4481515, at *6 (Dec. 21, 2007) (quoting *TSC Indus.*, 426 U.S. at 445), *petition denied*, 33 F. App'x 334 (D.C. Cir. 2008) (per curiam); *see also Basic Inc.*, 485 U.S. at 232 ("We now expressly adopt the *TSC Industries* standard of materiality for the § 10(b) and Rule 10b-5 context."); *SEC v. Blatt*, 583 F.2d 1325, 1331 (5th Cir. 1978) ("We should emphasize, however, that the test for materiality is objective.") (citing *TSC Indus.*).

28 *Ronald Effren*, Exchange Act Release No. 36713, 1996 WL 16981, at *3 (Jan. 16, 1996) (settlement order finding that respondent violated antifraud provisions and Rule 102(e)(1)(i) and (iii) by falsely holding himself out as a CPA and issuing an audit report that was included in an issuer's registration statement). While settled cases are not precedent, *Citizens Cap. Corp.*,

(continued...)

Here, during the Relevant Period, Respondents could not render the requisite professional opinion because the Firm's license had expired and the Firm was prohibited from providing attest services or representing that it was an accounting firm or CPA firm.[29] Significantly, the reason Respondents were not able to renew their license was because they failed to comply with TSBPA rules by reporting the results of a timely PCAOB inspection. The PCAOB's report was important to show that investors could rely on Respondents' professional expertise by demonstrating that they were in compliance with applicable accounting, auditing, and other attestation standards. Moreover, a reasonable investor would want to know that an audit report was signed by someone who had been expressly informed by the TSBPA, a state licensing authority, that he was not legally authorized to issue such an audit report because he had not satisfied the TSBPA's peer review requirements.

Respondents argue that the misrepresentations are not material. They urge that the "best and most probative evidence of materiality would be what an investor actually said regarding the importance of the supposedly false or omitted information in question" and that the Division failed to offer any evidence on this point. But "the reaction of individual investors is not determinative of materiality, since the standard is objective, not subjective."[30] "[M]ateriality depends on the significance the reasonable investor would place on the withheld or misrepresented information."[31] We have stated that, although in general materiality is primarily a factual inquiry, "the question of materiality is to be resolved as a matter of law when the information is 'so obviously important [or unimportant] to an investor, that reasonable minds

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(...continued)
Exchange Act Release No. 67313, 2012 WL 2499350, at *5 n.27 (June 29, 2012) (citation omitted), we "may use an opinion issued in connection with a settlement to state views on the issues presented in that case that [the Commission] would apply in other contexts." *George J. Kolar*, Exchange Act Release No. 46127, 2002 WL 1393652, at *4 (June 26, 2002) (finding that manager of broker-dealer failed to exercise reasonable supervision over registered representative who violated registration and antifraud provisions and that reference to a settled case with similar factual and legal findings was appropriate) (citation omitted).

[29] A firm is prohibited from providing attest services or holding itself out as an accounting or CPA firm unless it holds a validly issued license. TEX. OCC. CODE §§ 901.003, 901.456, 901.460; TEX. ADMIN. CODE § 501.80, Rules of Professional Conduct. At the very least, Respondents had a duty to know and observe the Rules of Professional Conduct. *See* TEX. ADMIN. CODE § 501.53 (stating that "[a]ll of the rules of professional conduct shall apply to and must be observed by" a CPA that practices in Texas).

[30] *Disraeli*, 2007 WL 4481515, at *6 & n.30 (citing *Richmark Capital Corp.*, Exchange Act Release No. 48758, 2003 WL 22570712, at *5 (Nov. 7, 2003) (citing *TSC Indus.*, 426 U.S. at 445)); *see also SEC v. Nat'l Student Mktg. Corp.*, 457 F. Supp. 682, 708 (D.D.C. 1978) (stating that the materiality analysis "is an [o]bjective one, involving the significance of an omitted or misrepresented fact to a [r]easonable investor, not the significance of the information to various individual investors") (citing *TSC Indus.*).

[31] *Disraeli*, 2007 WL 4481515, at *6 & n.31 (citing *Basic, Inc.*, 485 U.S. at 240).

cannot differ on the question of materiality.'"[32] We find that reasonable minds cannot differ here. The qualification of a CPA to render an opinion about an issuer's financial statements is and has been a fundamental aspect of an investor's decision about whether to invest in an issuer since the adoption of the Exchange Act in 1934.

Respondents state that, "due to the technical and administrative nature of the [Firm's] temporary license revocation, it is unreasonable and factually unsupported to assume the materiality of this revocation's non-disclosure to investors in the issuer companies." But the expiration was neither technical nor administrative. As demonstrated above, it was based on Respondents' failure to meet a requirement that goes to the heart of a CPA's competency and highlighted the fact that the PCAOB, a regulatory body uniquely qualified to evaluate a CPA firm's fitness to practice, had not yet resolved with the Respondents the significant audit deficiencies identified in its most recent inspection report.[33]

C. Respondents acted with scienter.

The Supreme Court has defined scienter as "a mental state embracing intent to deceive, manipulate, or defraud."[34] Scienter includes recklessness, defined as conduct that is "an extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the [respondent] or is so obvious that the [respondent] must have been aware of it."[35]

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32 *Id.* at *6 & n.32 (quoting *SEC v. Cochran*, 214 F.3d 1261, 1267 (10th Cir. 2000)) (alteration in original) (citations omitted); *see also TSC Indus.*, 426 U.S. at 450 ("Only if the established omissions are 'so obviously important to an investor, that reasonable minds cannot differ on the question of materiality' is the ultimate issue of materiality appropriately resolved 'as a matter of law' by summary judgment.") (citation omitted); *accord SEC v. Phan*, 500 F.3d 895, 908 (9th Cir. 2007) (same); *SEC v. Research Automation Corp.*, 585 F.2d 31, 35 (2d Cir. 1978) (same).

33 We take official notice pursuant to Rule 323 (permitting the Commission to take official notice of, for example, "any material fact which might be judicially noticed by a district court of the United States"), that, in fact, the PCAOB disciplined Respondents in a final order issued on February 8, 2012. *S.W. Hatfield, CPA and Scott W. Hatfield, CPA*, PCAOB File No. 105-2009-003 (Feb. 8, 2012). The record in that case indicates that the PCAOB's disciplinary action against Respondents was instituted in 2009 and was pending throughout the Relevant Period. On appeal, we sustained the PCAOB's findings of violation and determination to revoke the Firm's PCAOB registration and permanently bar Hatfield from association with a registered public accounting firm. *S.W. Hatfield, CPA and Scott W. Hatfield, CPA*, Exchange Act Release No. 69930, 2013 WL 3339647, at *26 (July 3, 2013).

34 *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976).

35 *Sundstrand Corp. v. Sun Chem. Corp.*, 553 F.2d 1033, 1045 (7th Cir. 1977); *Hollinger v. Titan Corp.*, 914 F.2d 1564, 1568-69 (9th Cir. 1990). The Division may demonstrate scienter by circumstantial evidence. *Herman & MacLean v. Huddleston*, 459 U.S. 375, 390 n.30 (1983); *Valicenti Advisory Servs., Inc. v. SEC*, 198 F.3d 62, 65 (2d Cir. 1999).

Respondents knew by at least March 8, 2010 that the Firm's license had not been renewed because that is when Hatfield received an email from the TSBPA expressly saying so.[36] Also in March, the TSBPA informed Respondents' counsel that, while Respondents' license was expired, they were not permitted to hold themselves out as CPAs and issue audit reports. The TSBPA reiterated this message to counsel in writing four months later.

Even before March 8, 2010, Respondents were at least reckless in misrepresenting their status. Respondents had been in the industry for over fifteen years and knew that the Firm had to renew its license annually. It is implausible that Respondents did not know that having a valid license was a prerequisite for holding themselves out as CPAs. Moreover, beginning in October 2009, well before the Firm's license expired, the TSBPA began to expressly notify Respondents through letters, e-mails, and telephone calls about the Firm's impending license expiration, the options Respondents had for renewing the Firm's license, and the consequences of not renewing the license. Respondents acted with *no* care when they held themselves out as CPAs, and the danger of deceiving investors about their qualifications could not have been more obvious.

Respondents argue that they did not act with scienter because there is no evidence that they acted with the specific, or even reckless, intent to deceive investors. Citing *Sundstrand Corp. v. Sun Chemical Corp.* and *Alvin W. Gebhart*, Respondents assert that "recklessness requires that the allegedly fraudulent material omission or misstatement 'derive from something more egregious than even 'white heart/empty head' good faith,'"[37] and that we must "'look at an actor's actual state of mind at the time of the relevant conduct.'"[38] Respondents assert that they tried repeatedly in good faith to have the PCAOB complete its inspection and maintained constant contact with the PCAOB and TSBPA regarding the status of the Firm's license.

When the defendant is aware of the facts that made the statement misleading, "'he cannot ignore the facts and plead ignorance of the risk.'"[39] Notwithstanding any efforts Respondents

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36 *Disraeli*, 2007 WL 4481515, at *5 n.25 ("The scienter of a corporation's officers and directors establishes the scienter of the corporation for purposes of the antifraud provisions." (internal quotation marks and citation omitted)); *see also A.J. White & Co. v. SEC*, 556 F.2d 619, 624 (1st Cir. 1977) (holding that a firm "can act only through its agents, and is accountable for the actions of its responsible officers").

37 *Sundstrand*, 553 F.2d at 1045. The *Sundstrand* court explained that recklessness includes subjective and objective components. The objective component is satisfied if the facts demonstrate that the danger of deceiving investors was known or so obvious that it would be known to any reasonable person. The subjective component is satisfied if the facts demonstrate something more than "'white heart/empty head' good faith" or "inexcusable negligence." *Id.*

38 *Gebhart*, Exchange Act Release No. 58951, 2008 WL 4936788, at *7 (Nov. 14, 2008), *pet. for review denied*, *Gebhart v. SEC*, 595 F.3d 1034 (9th Cir. 2010), *cert. denied*, 130 S. Ct. 3485 (June 21, 2010).

39 *SEC v. Platforms Wireless Intern. Corp.*, 617 F.3d 1072, 1094 (9th Cir. 2010) (quoting *Makor Issues & Rights, Ltd. v. Tellabs Inc.*, 513 F.3d 702, 704 (7th Cir. 2008) and holding that, in the context of a motion for summary judgment, "if no reasonable person could deny that the

(continued...)

may have made to renew the Firm's license, Respondents knew that those efforts were not successful during the Relevant Period. Thus, Respondents must have been cognizant of the obvious risk of deceiving investors by falsely identifying themselves as CPAs. For the reasons articulated above, we find that there is ample evidence to support our conclusion that Respondents acted with scienter. We therefore reject Respondents' arguments.

D. Misrepresentations were made "in connection with" the purchase or sale of securities.

The "in connection with" requirement is meant to be read broadly.[40] The requirement can be satisfied by statements made in public filings with the Commission, such as Forms 10-K and registration statements.[41] During the pendency of this appeal, we requested supplemental briefing from the parties to address, among other things, in what way any of the thirty-eight audit reports are "in connection with" the purchases or sales of securities of the twenty-one issuers.[42] In its response, the Division produced evidence that identifies certain audit reports along with details of related trading in the relevant issuers' securities.[43] The record establishes that

(...continued)
statement was materially misleading, a defendant with knowledge of the relevant facts cannot manufacture a genuine issue of material fact merely by denying (or intentionally disregarding) what any reasonable person would have known"); *see also Gebhart v. SEC*, 255 F. App'x 254, 255 (9th Cir. 2007) (unpublished) ("When warranted, the SEC is entitled to infer from circumstantial evidence that a defendant must have been cognizant of an extreme and obvious risk and reject as implausible testimony [or other evidence] to the contrary.").

40 *SEC v. Zandford*, 535 U.S. 813, 819-20 (2002) (interpreting Exchange Act Section 10(b)'s "in connection with" requirement broadly; noting that "the statute should be construed not technically and restrictively, but flexibly to effectuate its remedial purposes" (internal quotation marks omitted) (citing *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963))).

41 *See SEC v. Wolfson*, 539 F.3d 1249, 1262 (10th Cir. 2008) (finding that misrepresentations in a small business issuer's Form 10-K and 10-Q satisfied the "in connection with requirement"); *McGann v. Ernst & Young*, 102 F.3d 390, 397 (9th Cir. 1996) (finding that fraudulent Forms 10-K fall within the ambit of Exchange Act Section 10(b)); *Ames Dep't Stores, Inc. Stock Litig.*, 991 F.2d 953, 965 (2d Cir. 1993) (finding that the "in connection with" requirement is satisfied when misrepresentations are disseminated in public reports); *see also SEC v. Rana Research, Inc.*, 8 F.3d 1358, 1362 (9th Cir. 1993) ("Where the fraud alleged involves public dissemination in a document such as a press release, annual report, investment prospectus or other such document on which an investor would presumably rely, the 'in connection with' requirement is generally met by proof of the means of dissemination and the materiality of the misrepresentation or omission." (citing *Ames Dep't Stores*)).

42 Respondents did not reply. *See supra* note 19.

43 Attached to the Division's supplemental brief is a declaration of David R. King, a staff accountant, identifying the sources of information for the chart, including the Commission's public website, the OTCBB's public website, and a Bloomberg terminal located on Commission premises. We take official notice of the information sources pursuant to Rule 323.

purchases or sales occurred in the relevant issuers' securities after thirteen of the thirty-eight audit reports appeared in Forms 10-K or registration statements and while those reports were the most current on file (*i.e.*, while investors would have been relying on them). Those audit reports are as follows:

No.	Issuer	Audit Report	Issuer's Public Filing	Date Range of Purchase or Sale
1.	8888 Acquisition Corp.	Fiscal Year End ("FYE") 8/31/10 audit report dated 10/7/10	FYE 8/31/10 10-K filed 10/15/10	10/19/10 to 6/21/11
2.	Eight Dragons Co.	FYE 12/31/09 audit report dated 2/23/10	FYE 12/31/09 10-K filed 3/9/10	4/6/10 to 11/16/11
3.	Eight Dragons Co.	FYE 12/31/10 audit report dated 1/26/11	FYE 12/31/10 10-K filed 1/28/11	4/6/10 to 11/16/11
4.	HPC Acquisitions, Inc.	FYE 12/31/09 audit report dated 2/11/10	FYE 12/31/09 10-K filed 3/17/10	5/11/10 to 1/25/12
5.	HPC Acquisitions, Inc.	FYE 12/31/10 audit report dated 1/6/11	FYE 12/31/10 10-K filed 3/1/11	5/11/10 to 1/25/12
6.	Truwest Corp.	FYE 9/30/10 audit report dated 11/9/10	FYE 9/30/10 10-K filed 11/15/10	12/14/10 to 9/9/11
7.	X-Change Corp.	FYE 12/31/09 audit report dated 3/31/10	FYE 12/31/09 10-K filed 4/21/10	4/22/10 to 5/7/12
8.	X-Change Corp.	FYE 12/31/10 audit report dated 1/14/11	FYE 12/31/10 10-K filed 1/18/11	4/22/10 to 5/7/12
9.	Asia Green Agriculture Corp. f/k/a SMSA Palestine Acquisition Corp.	FYE 12/31/09 audit report dated 3/15/10	FYE 12/31/09 10-K filed 3/30/10	4/21/10 to 7/23/10
10.	Marketing Acquisition Corp.	FYE 12/31/09 audit report dated 3/2/10	FYE 12/31/09 10-K filed 3/5/10	3/16/10 to 3/28/11
11.	Signet International Holdings, Inc.	FYE 12/31/09 audit report dated 4/7/10	FYE 12/31/09 10-K filed 4/12/10	4/13/10 to 3/29/11
12.	SMSA Gainesville Acquisition Corp.	FYE 12/31/09 audit report dated 3/11/10	FYE 12/31/09 10-K filed 3/16/10	10/15/10 to 10/28/10
13.	SMSA Crane Acquisition Corp.	FYE 12/31/09 audit report dated 2/17/10	Form 10-12G/A filed 2/22/10	11/5/10

We find that the misstatements in the thirteen audit reports listed above are "in connection with" the purchase or sale of securities and that, the other elements of the violation having been met, Respondents violated Exchange Act Section 10(b) and Rule 10b-5 thereunder.

E. Respondents' violations were willful.

Under Exchange Act Section 4C(a)(3) and Rule 102(e)(1)(iii), the Commission may

> censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission after notice and opportunity for hearing in the matter . . . to have willfully violated, or willfully aided and abetted the violation of any provision of the federal securities laws or the rules and regulations thereunder.

We have found that Respondents violated the federal securities laws. The question here is whether Respondents did so willfully.

It is well established that a willful violation of the securities laws means "intentionally committing the act which constitutes the violation" and does not require that the actor "also be aware that he is violating one of the Rules or Acts."[44] There is no dispute that Respondents intentionally identified themselves as CPAs in audit reports that they issued for inclusion in public filings. Respondents argue that their "mental state in permitting SWH's license to lapse and in issuing any relevant audit reports during that time was far less than intentional or the result of any willfulness on their part." But the record evidence contradicts their argument. Respondents also argue that "there is no evidence that the Respondents acted willfully, that is, with the specific intent to deceive investors or potential investors." The intent to deceive, *i.e.*, scienter, is different from the intent to the commit the act, *i.e.*, willfulness, and we have addressed Respondents' scienter above. We thus reject Respondents' arguments and find that Respondents acted willfully.

Accordingly, for all of the above reasons, we find that there is no genuine issue with regard to any material fact and that the Division is entitled to a summary disposition as a matter of law that Respondents willfully violated Exchange Act Section 10(b) and Rule 10b-5 thereunder within the meaning of Exchange Act Section 4C(a)(3) and Rule 102(e)(1)(iii).

IV. Sanctions

A. Respondents are denied the privilege of appearing or practicing before the Commission under Exchange Act Section 4C(a)(3) and Rule 102(e)(1)(iii).

In assessing the need for sanctions in the public interest, we consider, among other things: the egregiousness of the respondent's actions, the isolated or recurrent nature of the

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44 *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (internal quotation marks and citation omitted).

infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the likelihood that the respondent's occupation will present opportunities for future violations. Our "inquiry into . . . the public interest is a flexible one, and no one factor is dispositive."[45] We also consider the extent to which the sanction will have a deterrent effect.[46]

Respondents' actions were egregious and recurrent. They repeatedly issued audit reports for over one year while the Firm failed to possess a license despite knowing they were prohibited from doing so. Respondents concealed the truth from the investing public by issuing such audit reports despite knowing that they were prohibited from doing so, and thus acted with a high degree of scienter. Respondents make no assurances against future violations and do not recognize the wrongful nature of their conduct. In fact, Respondents continue to blame the PCAOB for the license expiration, asserting that "it was in no way [their] fault or responsibility . . . ." Respondents ignore that they are the only ones responsible for issuing audit reports despite not holding a valid firm license. We find that Respondents' callous disregard for such a basic regulatory requirement as the necessity of having a license to practice as a certified public accountant demonstrates that there is a high likelihood that they will commit future violations.

On July 3, 2013, following Respondents' appeal of a separate disciplinary proceeding by the PCAOB regarding conduct unrelated to this proceeding, we sustained PCAOB's decision to revoke the Firm's PCAOB registration and permanently bar Hatfield from association with a registered public accounting firm.[47] But those sanctions do not prohibit Respondents from appearing and practicing before the Commission in other capacities, such as working in an accounting capacity for Commission-registered investment advisers.[48] As we have stated, "[t]he

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45 *Michael C. Pattison*, Exchange Act Release No. 67900, 2012 WL 4320146, at *8 (Sept. 20, 2012) (citing *Disraeli*, 2007 WL 4481515, at *15).

46 *Id.* (citing *James E. Franklin*, Exchange Act Release No. 56649, 2007 WL 2974200, at *6 & n.28 (Oct. 12, 2007) (citing *Ahmed Mohamed Soliman*, Exchange Act Release No. 35609, 1995 WL 237220, at *3 n.12 (Apr. 17, 1995); *Lester Kuznets*, Exchange Act Release No. 23525, 1986 WL 625417, at *3 (Aug. 12, 1986); *McCarthy v. SEC*, 406 F.3d 179, 188, 190 (2d Cir. 2005))).

47 *S.W. Hatfield, CPA*, 2013 WL 3339647, at *26. Pursuant to Rule 323, we take official notice that in March 2014, the TSBPA revoked Hatfield's and the Firm's licenses citing violations regarding discreditable acts, violation of a rule of professional conduct adopted by the Board, conduct indicating a lack of fitness to serve the public as a professional accountant, and an "other rule or order violation."

48 *See James M. Schneider, CPA*, Exchange Act Release No. 69922, 2013 WL 3327751, at *6 (July 2, 2013) (finding that a Rule 102(e) order protects against the "breadth of ways in which accountants can threaten our processes" and denying respondent's motion for the Commission to clarify that his Rule 102(e) suspension order did not preclude him from "serving on the audit committee of a Commission registrant or as the CFO of a public company, so long as he does not serve as the principal accounting officer" (citing *SEC v. Brown*, 878 F. Supp. 2d 109, 125 (D.D.C. 2012) (quoting *Armstrong*, 2005 WL 1498425, at *11-12 (finding that the controller of a

(continued...)

Commission disciplines professionals pursuant to Rule 102(e) in order to 'protect the integrity of its processes.'"[49] We find that permanently disqualifying Respondents from appearing or practicing before the Commission is remedial because it will prevent Respondents and deter others from disregarding their professional responsibilities and protect the investing public by encouraging diligent compliance with regulatory requirements. Because we have found that a bar under Exchange Act Section 4C(a)(3) and Rule 102(e)(1)(iii) is in the public interest, we do not reach the need for a sanction under Exchange Act Section 4C(a)(1) and Rule 102(e)(1)(i).

B. A cease-and-desist order is warranted.

Exchange Act Section 21C(a) authorizes us to impose a cease-and-desist order on any person who is violating, has violated, or is about to violate that Act or any rule thereunder.[50] In determining whether a cease-and-desist order is appropriate, we consider, in addition to the factors above, "whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions."[51]

We conclude that a cease-and-desist order is necessary. The violations are recent, having occurred from 2010 to 2011. Although the record does not identify any pecuniary harm to investors, our public interest analysis "focus[es] . . . on the welfare of investors generally."[52] Investors and the marketplace are harmed when a purported CPA misrepresents his qualification to opine on an issuer's financial statements because such conduct undermines the reliability of fundamental investment tools that help investors make informed decisions. We conclude that Respondents pose a substantial, continuing risk of harm to investors and the marketplace. A cease-and-desist order will serve the remedial purpose of encouraging Respondents to understand and obey their obligations under the securities laws.

(...continued)
public company's subsidiary appeared and practiced before the Commission as an accountant)))); *accord SEC v. Prince*, No. 09-1423, 942 F. Supp. 2d 108, 146 (D.D.C. May 2, 2013) (quoting *Armstrong* and finding that a public company employee, serving as "Director of Mergers and Acquisitions," violated a Rule 102(e) order by appearing and practicing before the Commission as an accountant).

49 *Pattison*, 2012 WL 4320146, at *12 & n.70 (citing *Armstrong*, 2005 WL 1498425, at *11 & n.62 (citing *Touche Ross & Co. v. SEC*, 609 F.2d 570, 582 (2d Cir. 1979) (stating that Rule of Practice 2(e), the predecessor to Rule of Practice 102(e), "represents an attempt by the Commission to protect the integrity of its own processes" and upholding the validity of Rule of Practice 2(e) as "reasonably related" to the purposes of the federal securities laws))).

50 15 U.S.C. § 78u-3(a).

51 *KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 2001 WL 47245, at *26 (Jan. 19, 2001), *petition denied*, 289 F.3d 109 (D.C. Cir. 2002).

52 *Kornman*, 2009 WL 367635, at *9.

C. Disgorgement, plus prejudgment interest, is appropriate.

Exchange Act Section 21C(e) authorizes disgorgement, including reasonable prejudgment interest, in a cease-and-desist proceeding.[53] Disgorgement is an equitable remedy designed to deprive wrongdoers of their unjust enrichment and deter others from similar misconduct.[54] Accordingly, "[t]he amount of disgorgement should include all gains flowing from the illegal activities," but calculating disgorgement "requires only a reasonable approximation of profits causally connected to the violation."[55] Once the Division shows that its disgorgement figure is a reasonable approximation of the amount of unjust enrichment, the burden shifts to the respondents to demonstrate that the Division's estimate is not a reasonable approximation.[56] Where disgorgement cannot be exact, the "well-established principle" is that the burden of uncertainty in calculating ill-gotten gains falls on the wrongdoer whose illegal conduct created that uncertainty.[57]

The record shows that total fees charged by Respondents for the thirteen reports issued in violation of the antifraud provisions is $112,529. We conclude that this amount represents a reasonable approximation of Respondents' ill-gotten gains.[58] Respondents have submitted no evidence to the contrary and therefore have not met their burden of showing that this estimate is not a reasonable approximation. We order Respondents to disgorge $112,529 plus prejudgment interest.[59] Because the misconduct committed by Hatfield and the Firm was inextricably

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[53] 15 U.S.C. § 78u-3(e).

[54] *See, e.g., Platforms Wireless*, 617 F.3d at 1096 (quoting *SEC v. First Pacific Bancorp*, 142 F.3d 1186, 1191 (9th Cir. 1998) ("Disgorgement is designed to deprive a wrongdoer of unjust enrichment, and to deter others from violating securities laws by making violations unprofitable.")).

[55] *Id.* (quoting *SEC v. JT Wallenbrock & Assocs.*, 440 F.3d 1109, 1114 (9th Cir. 2006) and *First Pacific Bancorp*, 142 F.3d at 1192 n.6).

[56] *Id.* (quoting *SEC v. First City Fin. Corp.*, 890 F.2d 1215, 1232 (D.C. Cir. 1989)).

[57] *Id.* (quoting *First City Fin. Corp.*, 890 F.3d at 1232).

[58] The Division urges us to impose disgorgement of fees paid to Respondents for all thirty-eight audit reports at issue because such disgorgement "comports with prior Commission decisions in which unregistered auditors were required to disgorge audit fees for work performed in violation of Section 102(a) of the Sarbanes-Oxley Act of 2002 . . . ." But Respondents were not charged with such a violation. We order disgorgement here for violations charged and proven by the Division.

[59] *Terence Michael Coxon*, Exchange Act Release No. 48385, 2003 WL 21991359, at *14 (Aug. 21, 2003) ("[E]xcept in the most unique and compelling circumstances, prejudgment interest should be awarded on disgorgement, among other things, in order to deny a wrongdoer the equivalent of an interest free loan from the wrongdoer's victims."), *aff'd*, 137 F. App'x 975 (9th Cir. 2005); 17 C.F.R. § 201.600(b) (stating that "[i]nterest on the sum to be disgorged shall be computed at the underpayment rate of interest established under Section 6621(a)(2) of the Internal Revenue Code, 26 U.S.C. § 6621(a)(2), and shall be compounded quarterly").

entwined, their liability for the disgorgement and prejudgment interest shall be joint-and-several.[60]

D. A second-tier civil monetary penalty is in the public interest.

Exchange Act Section 21B(a)(1)(A) authorizes us to impose a civil monetary penalty for willful violations of the federal securities laws.[61] In considering whether a civil penalty is in the public interest, we consider: whether the conduct involved fraud or resulted in harm to others; the extent to which any person was unjustly enriched; whether the individual has committed prior violations; the need for deterrence; and such other matters as justice may require.[62] Second-tier penalties are appropriate if the violation "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement," and third-tier penalties are appropriate if, in addition, the violation "directly or indirectly resulted in substantial losses or created a significant risk of substantial losses to other persons or resulted in substantial pecuniary gain to the person who committed" the violation.[63]

The Division seeks a second-tier penalty, and we find this appropriate. As discussed above, Respondents' conduct involved fraud and deceit under the securities laws and undermined the reliability of disclosure resources used by investors to make investment decisions. The record does not demonstrate any pecuniary loss to investors, and Respondents' pecuniary gain (*i.e.*, the audit report fees) is not substantial. Respondents' unjust enrichment also is not substantial. Respondents have a disciplinary history and were sanctioned by the PCAOB for having engaged in improper professional conduct in the audit of the financial statements of two public companies.[64] Respondents' misconduct addressed in the PCAOB proceeding, together with the misconduct here, demonstrates that the need for deterrence is high.

The statutory maximum amount that may be imposed as a second-tier penalty for each act or omission occurring after March 3, 2009 but before March 5, 2013 is $75,000 against a natural

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60 *Montford and Co., Inc., d/b/a Montford Assoc. and Ernest V. Montford, Sr.*, Investment Advisers Act Release No. 3829, 2014 WL 1744130, at *23 & n.205 (May 2, 2014) ("Numerous courts recognize that 'where two or more individuals or entities collaborate or have a close relationship in engaging in the violations of securities laws, they have been held jointly and severally liable for the disgorgement of illegally obtained proceeds.'") (quoting *David R. Lehl*, Securities Act Release No. 8102, 2002 WL 1315552, at *14 (May 20, 2002) (citation omitted)); *see also SEC v. Hughes Capital Corp.*, 124 F.3d 449, 455 (3d Cir. 1997) ("When apportioning [disgorgement] liability among multiple tortfeasors, it is appropriate to hold all tortfeasors jointly and severally liable for the full amount of the damage unless the liability is reasonably apportioned.").

61 15 U.S.C. § 78u-2(a)(1)(A).

62 *Id.* § 78u-2(c).

63 *Id.* § 78u-2(b).

64 *S.W. Hatfield, CPA*, 2013 WL 3339647, at *1, *24.

person and $375,000 against any other person.[65] Within this statutory framework, we have discretion in setting the amount of penalty.[66] We find that a civil penalty in the total amount of $110,500, for which Respondents are jointly and severally liable, is appropriate. The figure represents a second-tier penalty of $8,500 for each of the thirteen audit reports issued by Respondents while the Firm's license was expired.

An appropriate order will issue.[67]

By the Commission (Chair WHITE and Commissioners AGUILAR, GALLAGHER, STEIN, and PIWOWAR).

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

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[65] *See* Debt Collection Improvement Act of 1996, Pub. L. 104-134, title III, § 31001; 17 C.F.R. § 201.1004.

[66] *Phlo Corp.*, Exchange Act Release No. 55562, 2007 WL 966943, at *14 (Mar. 30, 2007).

[67] We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73763 / December 5, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3602 / December 5, 2014

Admin. Proc. File No. 3-15012

In the Matter of

S.W. HATFIELD, CPA and
SCOTT W. HATFIELD, CPA

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that S.W. Hatfield, CPA and Scott W. Hatfield, CPA are permanently denied the privilege of appearing or practicing before the Commission as accountants; and it is further

ORDERED that S.W. Hatfield, CPA and Scott W. Hatfield, CPA cease and desist from committing or causing any violations or future violations of Exchange Act Section 10(b) and Rule 10b-5 thereunder; and it is further

ORDERED that S.W. Hatfield, CPA and Scott W. Hatfield, CPA, jointly and severally, disgorge $112,529, plus prejudgment interest of $18,469.78, such prejudgment interest calculated beginning from March 1, 2010, in accordance with Commission Rule of Practice 600; and it is further

ORDERED that S.W. Hatfield, CPA and Scott W. Hatfield, CPA pay a civil monetary penalty of $110,500, for which they are jointly and severally liable.

Payment of the amounts to be disgorged and the civil money penalty shall be: (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed to Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, 6500 South MacArthur Blvd., Oklahoma City, OK 73169; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73765 / December 5, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16298

In the Matter of **ROBERT A. HEMM** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Robert A. Hemm ("Hemm" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

1 The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Summary

1. These proceedings arise out of insider trading by Robert A. Hemm. On July 20, 2011, Hemm purchased stock of SFN Group, Inc. ("SFN") on the basis of material nonpublic information that he learned from a relative. At the time, Hemm's relative was an advisor to one of the parties involved in a soon-to-be announced tender offer for SFN by Randstad Holding nv (the "Tender Offer"). Hemm's relative informed Hemm of the Tender Offer, and Hemm misappropriated that information -- in breach of his duty of trust and confidence to his relative -- by purchasing 5,000 shares of SFN stock just hours prior to Randstad's public announcement of the Tender Offer. Approximately two weeks after the announcement, Hemm sold the stock for a profit of $21,763.

Respondent

2. **Robert A. Hemm**, 85 years old, is a resident of Pelham, New York.

Other Relevant Entities

3. **SFN Group, Inc.** was a Delaware corporation headquartered in Fort Lauderdale, Florida. SFN's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and traded on the New York Stock Exchange under the symbol "SFN." SFN was a strategic workforce solutions provider, offering temporary and permanent staffing solutions.

4. **Randstad Holding nv** ("RAND") is a Dutch multinational human resource consulting firm headquartered in the Netherlands. RAND is listed on the NYSE Euronext Amsterdam. On July 20, 2011, RAND announced that the company had entered into a definitive agreement to acquire SFN through a cash tender offer. The transaction closed on September 2, 2011.

Background

5. On July 12, 2011, Hemm's relative began working on the Tender Offer. Prior to purchasing SFN stock on July 20, Hemm spoke several times to his relative, including several times on the day Hemm purchased SFN stock. On at least one of those occasions, Hemm's relative informed Hemm of the soon-to-be announced Tender Offer.

6. On the basis of that information, in the early afternoon of July 20, 2011, Hemm purchased a total of 5,000 shares of SFN common stock at an average price of $9.23 per share in his and his wife's brokerage accounts.

7. By July 20, 2011, substantial steps had been taken in furtherance of the Tender Offer. Both SFN and RAND had signed confidentiality agreements, retained lawyers and investment bankers, and RAND had conducted extensive due diligence.

8. On July 20, 2011, after the market closed, RAND announced the Tender Offer, stating that RAND had agreed to acquire SFN for $14.00 per share. On the next trading day, SFN's stock closed at $13.93, an increase of $4.71 per share, or 51%, from the prior day's close, on a trading volume of approximately 25.8 million shares (the previous day's volume was approximately 281,182 shares).

9. On August 8, 2011, Hemm sold his SFN shares at a profit of $21,763.

10. Hemm knew that the information he obtained from his relative concerning the Tender Offer was material and non-public. By purchasing shares of SFN on the basis of that information, Hemm breached the duty of trust and confidence that he owed to his relative.

11. As a result of the conduct described above, Hemm violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder prohibiting fraud in connection with the purchase or sale of securities, and Section 14(e) of the Exchange Act and Rule 14e-3 thereunder, prohibiting trading while in possession of material nonpublic information that was acquired directly or indirectly from someone working on behalf of the offeror or target of a tender offer.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Hemm's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Sections 21C of the Exchange Act, Respondent Hemm cease and desist from committing or causing any violations and any future violations of Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 14(e) of the Exchange Act and Rule 14e-3 thereunder.

B. Respondent shall, within 15 days of the entry of this Order, pay disgorgement of $21,763, prejudgment interest of $1,923, and a civil penalty of $21,763 to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways: (1) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or (2) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Hemm as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Andrew M. Calamari, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, 200 Vesey Street, Suite 400, New York, New York, 10281-1022.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar dissented as to penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73768 / December 8, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3603 / December 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16299

In the Matter of BKD, LLP, Respondent.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against BKD, LLP ("Respondent" or "BKD") pursuant to Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[2]

1 Section 4C provides, in relevant part, that:

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

2 Rule 102(e)(1)(ii) provides, in pertinent part, that:

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[3] that:

A. SUMMARY

This matter concerns violations of the Commission's auditor independence rules by BKD. BKD audited the annual financial statements that were filed with the Commission for 21 broker-dealer audit clients for the fiscal years 2010, 2011, and/or 2012. For at least one audit of nine of these broker-dealer audit clients, BKD was not independent under auditor independence criteria established by the Commission and made applicable by Exchange Act Rule 17a-5(f)(3) to audits of brokers and dealers.[4] As a result of this conduct, BKD engaged in improper professional conduct, violated the auditor independence rules, and caused each of the broker-dealers' failure to file an annual report audited by an independent accountant.

B. RESPONDENT

Respondent BKD, a limited liability partnership, is an accounting and auditing firm registered with the Public Company Accounting Oversight Board ("PCAOB"). BKD has 245 partners and roughly 1,200 additional professional staff located in 34 offices in 15 states, with its principal office in the state of Missouri.

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3 The findings are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

4 The provisions of Exchange Act Rule 17a-5 referred to herein are those in effect during, and applicable to, the relevant conduct. On July 30, 2013, the Commission adopted certain amendments to Rule 17a-5. *See* Broker-Dealer Reports, SEC Exchange Act Release No. 34-70073 (July 30, 2013), 78 Fed. Reg. 51910 (Aug. 21, 2013). Among other things, the amendments to Rule 17a-5 require that audits of brokers and dealers be performed in accordance with Public Company Accounting Oversight Board standards, effective for audits of fiscal years ending on or after June 1, 2014. The auditor independence requirement of Rule 2-01 of Regulation S-X applied to broker-dealer audits both before and after the July 30, 2013 amendments. At the time of the relevant conduct, prior to the amendments, that requirement was set out in Rule 17a-5(f)(3). It is now set out in Rule 17a-5(f)(1).

C. FACTS

1. Lack of Independence

a. During fiscal years 2010 through 2012 (the "Relevant Period"), BKD served as the independent public accountant for 21 broker-dealer audit clients. In connection with at least one audit performed for nine of its broker-dealer audit clients during the Relevant Period, BKD prepared the financial statements and/or notes to the financial statements that were filed with the Commission on Form X-17A-5.

b. For example, BKD audited the annual financial statements for one such broker-dealer ("Broker-Dealer A") for the fiscal year ending 2011. During the audit, BKD was provided with financial documents generated by Broker-Dealer A, including a trial balance and FOCUS reports.

c. BKD then utilized the information contained in these and other source documents to create a set of financial statements to be filed with the Commission. In particular, using the prior year's financial statements as a template, BKD personnel working on BKD computers used their engagement software to create the new set of financial statements, including the notes to the financial statements. BKD then provided the set of financial statements it had prepared to Broker-Dealer A's management for approval.

d. In February 2012, Broker-Dealer A filed with the Commission a Form X-17A-5 Part III for the fiscal year ended 2011. Included in that filing is an audit report signed by BKD and stating, among other things, that BKD's audit of Broker-Dealer A was conducted "in accordance with auditing standards generally accepted in the United States of America."

e. BKD engaged in substantially similar conduct in connection with at least one audit for eight additional broker-dealer clients during the Relevant Period.

2. Violations

a. Section 17(e)(1)(A) of the Exchange Act requires that every registered broker or dealer "annually file with the Commission a balance sheet and income statement certified by an independent public accounting firm, or by a registered public accounting firm if the firm is required to be registered under the Sarbanes-Oxley Act of 2002, prepared on a calendar or fiscal year basis, and such other financial statements (which shall, as the Commission specifies, be certified) and information concerning its financial condition as the Commission, by rule may prescribe as necessary or appropriate in the public interest or for the protection of investors."

b. Exchange Act Rule 17a-5(e)(1)(i) states: "An audit shall be conducted by a public accountant who shall be in fact independent as defined in paragraph (f)(3) of this section herein, and he shall give an opinion covering the statements filed pursuant to paragraph (d) . . . ." Exchange Act Rule 17a-5(f)(3) further states that, for such audits, "[a]n accountant shall be independent in accordance with the provisions of Rule 2-01(b) and (c) of Regulation S-X."

c. Exchange Act Rule 17a-5(g) requires that "[t]he audit shall be made in accordance with generally accepted auditing standards" and Exchange Act Rule 17a-5(i) requires that "[t]he accountant's report shall . . . [s]tate whether the audit was made in accordance with generally accepted auditing standards." Generally accepted auditing standards ("GAAS") require auditors to maintain strict independence from their audit clients. *See* Statement on Auditing Standard No. 1, Section 220.03. Accordingly, if an auditor's report states that its audit was performed in accordance with GAAS when the auditor was not independent, then it has violated Exchange Act Rule 17a-5(i). *See In the Matter of Rosenberg Rich Baker Berman & Company and Brian Zucker, CPA,* Exchange Act Release No. 69765 at p. 5 (June 14, 2013).

d. Rule 2-01(c)(4) of Regulation S-X provides that accountants are not independent if, at any point during the audit and professional engagement period, the accountant provides prohibited non-audit services to an audit client. Rule 2-01(c)(4)(i) of Regulation S-X provides that prohibited non-audit services include bookkeeping or other services related to the accounting records or financial statements of the audit client, and defines such services as:

> Any service, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including:
>
> (A) Maintaining or preparing the audit client's accounting records;
>
> (B) Preparing the audit client's financial statements that are filed with the Commission or that form the basis of financial statements filed with the Commission; or
>
> (C) Preparing or originating source data underlying the audit client's financial statements.

e. Rule 2-01(c)(4)(i) of Regulation S-X specifically prohibits an audit firm from preparing an audit client's financial statements that are filed with the Commission. In this context, preparing financial statements includes but is not limited to: aggregating line items from internal books and records to the financial statements; changing line item descriptions; drafting or editing notes to the financial statements; and converting FOCUS reports or bookkeeping software program reports into financial statements. With respect to the audit of Broker-Dealer A, and the additional audits in which BKD engaged in substantially similar conduct, BKD engaged in one or more of the above prohibited actions.

f. As a result of BKD's conduct described above, BKD was not independent of its broker-dealer audit clients under the independence criteria established by Rule 2-01(c)(4) of Regulation S-X, which Exchange Act Rule 17a-5 made applicable to the audits of broker-dealer financial statements. As the Commission explained in adopting Rule 2-01(c)(4), providing such services for an audit client "impairs the auditor's independence because the auditor will be placed in the position of auditing the firm's work when auditing the client's financial statements. . . . In addition, keeping the books is a management function, the performance of which leads to an inappropriate mutuality of interests between the auditor and the audit client." *Revision of the Commission's Auditor Independence Requirements*, Exchange Act Release No. 43602, at IV.D.4.b(i) (November 21, 2000). *See also Strengthening the Commission's Requirements Regarding Auditor Independence*, Exchange Act Release No. 47265 ("keeping the books is a management function, which also is prohibited")(January 28, 2003).

g. BKD violated Exchange Act Rule 17a-5(i) by representing in its audit reports that it had performed the audits of the broker-dealers' financial statements in accordance with GAAS when in fact, because of the independence impairment described above, the audits had not been performed in accordance with GAAS.

h. Exchange Act Section 17(a) and Rule 17a-5 require broker-dealers to file annual reports containing financial statements audited by independent public accountants. No showing of scienter is necessary to establish a violation of Exchange Act Section 17(a)(1). *See In the Matter of Orlando Joseph Jett*, Exchange Act Release No. 49366 at n.45 (March 5, 2004) (citing *SEC v Drexel Burham Lambert Inc.*, 837 F. Supp. 587, 610 (S.D.N.Y. 1993); *Stead v. SEC*, 444 F.2d 713, 716-17 (10th Cir. 1971), *cert denied*, 404 U.S. 1059 (1972)).

i. Under Section 21C of the Exchange Act, a person is a "cause" of another's primary violation if the person knew or should have known that his act or omission would contribute to the primary violation. Negligence is sufficient to establish "causing" liability under Section 21C when a person is alleged to have caused a primary violation that does not require scienter. *In re KPMG Peat Marwick*, Exch. Act. Rel. No. 43862 (Jan. 19, 2001), *aff'd, KPMG v. SEC*, 289 F.3d 109 (D.C. Cir. 2002).

j. BKD caused its broker-dealer audit clients to violate Exchange Act Section 17(a) and Rule 17a-5. BKD, an audit firm registered with the PCAOB, knew or should have known that its conduct, including incorrectly stating in audit reports that the audits were conducted in accordance with GAAS, contributed to its audit clients' violations of Exchange Act Section 17(a) and Rule 17a-5.

k. Rule 102(e) of the Commission's Rules of Practice allows the Commission to censure a person if it finds that such person has engaged in "improper professional conduct." Exchange Act § 4C(a)(2); Rule 102(e)(1)(ii). Rule 102(e) defines improper professional conduct, in part, as: "[a] single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the registered public accounting firm or associated person knows, or should know, that heightened scrutiny is warranted." Exchange Act § 4C(b)(2); Rule 102(e)(1)(iv)(B).

l. Questions regarding an auditor's independence always warrant heightened scrutiny. *See* Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57,164, 57,168 (Oct. 26, 1998) (codified at 17 C.F.R. Part 201). The Commission has defined the "highly unreasonable" standard as:

> an intermediate standard, higher than ordinary negligence but lower than the traditional definition of recklessness used in cases brought under Section 10(b) of the Exchange Act and Rule 10b-5 of the Exchange Act. The highly unreasonable standard is an objective standard. The conduct at issue is measured by the degree of the departure from professional standards and not the intent of the accountant.

Id. at 57,167; *see also In the Matter of Ernst & Young LLP*, Admin. Proc. File No. 3-10933, SEC Initial Decision Release No. 249, at 60 (Apr. 16, 2004).

m. Based on the conduct set forth above, BKD engaged in highly unreasonable conduct that resulted in violations of applicable professional standards when it knew or should have known that heightened scrutiny was required.

3. **Findings**

a. Based on the foregoing, the Commission finds that BKD engaged in improper professional conduct pursuant to Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

b. Based on the foregoing, the Commission finds that BKD committed violations of Exchange Act Rule 17a-5(i) and caused nine broker-dealers' violations of Section 17(a) and Rule 17a-5 promulgated thereunder.

4. **Respondent's Remedial Efforts and Cooperation**

In determining to accept the Offer, the Commission considered the remedial acts undertaken by Respondent and the cooperation afforded the Commission staff. As part of its remediation, BKD has already implemented or begun to implement some of the Undertakings listed below.

5. **Undertakings**

BKD undertakes:

a. within ninety (90) days from the date of the Order, to establish written policies and procedures, or to revise and/or supplement existing written policies and procedures, for the purpose of providing BKD with reasonable assurance of compliance with applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement (defined to mean an engagement to provide a report – whether an audit report, an examination report, or a review report – required under Exchange Act Rule 17a-5(d)(1)(i)(C), as amended);

b. within ninety (90) days from the date of the Order, to establish a policy of ensuring training, whether internal or external, on an annual or more frequent regular basis, concerning applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement, of any Firm audit personnel who participate in any way in the planning or performing of any SEC Registered Broker-Dealer Engagement;

c. within ninety (90) days from the date of the Order and before BKD's commencement of any SEC Registered Broker-Dealer Engagement (or, where BKD by the date of this Order has already commenced but not completed such an engagement, before BKD's release of its report), to ensure training pursuant to the policy described in paragraph (5)(b) above has been provided on at least one occasion;

d. to provide a copy of the Order –

(i) within thirty (30) days from the date of the Order, to all audit personnel who serve broker-dealer or SEC registrant clients and are employed by, or associated with (as defined in PCAOB Rule 1001(p)(i)), BKD as of the date of the Order; and

(ii) within thirty (30) days from the date of the Order, to any client of BKD as of the date of the Order for which BKD has performed or has been engaged to perform an SEC Registered Broker-Dealer Engagement;

e. within ninety (90) days from the date of the Order, to designate and maintain at least one partner (the "Independence Partner") in its national office or headquarters with responsibility for monitoring BKD's compliance with the SEC's auditor independence rules, including without limitation, the adoption, implementation and oversight of policies and procedures designed to provide BKD with reasonable assurance of such compliance;

f. within ninety (90) days from the date of the Order, to adopt and implement written procedures to provide reasonable assurance that prohibited bookkeeping services will not be provided in connection with any SEC Registered Broker-Dealer Engagement, including procedures requiring BKD to complete, on an annual basis, a client continuance form for each SEC Registered Broker-Dealer Engagement, which shall contain an assessment of risks and a listing of non-audit services being provided, and procedures requiring BKD's Independence Partner to monitor the annual completion and review of client continuance forms for all SEC Registered Broker-Dealer Engagements as well as the annual review of such other documents, forms or other information sufficient to determine whether any prohibited bookkeeping services are being provided in connection with any SEC Registered Broker-Dealer Engagements; and

g. to certify in writing to Stephen L. Cohen, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5553, BKD's compliance with paragraphs 5(a) through 5(f) above. The certification, which shall be signed by the Independence Partner, shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. BKD shall submit such certification within one hundred twenty (120) days from the date of the Order. BKD shall also submit such additional evidence of and information concerning compliance as the staff of the Division of Enforcement may reasonably request.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent BKD's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. BKD is hereby censured.

B. BKD shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-5 promulgated thereunder.

C. BKD shall comply with the undertakings enumerated in Section (III)(C)(5) above.

D. BKD shall, within seven days of the entry of this Order, pay a civil money penalty in the amount of $15,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying BKD as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Stephen L. Cohen, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5553.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73769 / December 8, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3604 / December 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16300

In the Matter of

Robert Cooper and Company, CPA PC,

Respondent.

ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Robert Cooper and Company, CPA PC ("Respondent" or "Cooper") pursuant to Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[2]

---

1 Section 4C provides, in relevant part, that:

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

2 Rule 102(e)(1)(ii) provides, in pertinent part, that:

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[3] that:

A. SUMMARY

This matter concerns violations of the Commission's auditor independence rules by Cooper. Cooper audited the annual financial statements that were filed with the Commission for twelve broker-dealer audit clients for the fiscal years 2010, 2011, and/or 2012. For the 2011 audit of one of these broker-dealer audit clients, Cooper was not independent under auditor independence criteria established by the Commission and made applicable by Exchange Act Rule 17a-5(f)(3) to audits of brokers and dealers.[4] As a result of this conduct, Cooper engaged in improper professional conduct, violated the auditor independence rules, and caused the broker-dealer's failure to file an annual report audited by an independent accountant.

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

3 The findings are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

4 The provisions of Exchange Act Rule 17a-5 referred to herein are those in effect during, and applicable to, the relevant conduct. On July 30, 2013, the Commission adopted certain amendments to Rule 17a-5. *See* Broker-Dealer Reports, SEC Exchange Act Release No. 34-70073 (July 30, 2013), 78 Fed. Reg. 51910 (Aug. 21, 2013). Among other things, the amendments to Rule 17a-5 require that audits of brokers and dealers be performed in accordance with Public Company Accounting Oversight Board standards, effective for audits of fiscal years ending on or after June 1, 2014. The auditor independence requirement of Rule 2-01 of Regulation S-X applied to broker-dealer audits both before and after the July 30, 2013 amendments. At the time of the relevant conduct, prior to the amendments, that requirement was set out in Rule 17a-5(f)(3). It is now set out in Rule 17a-5(f)(1).

B. RESPONDENT

Respondent Cooper, a professional corporation, is an accounting and auditing firm registered with the Public Company Accounting Oversight Board ("PCAOB"). Cooper has one partner, Robert Cooper, who is located in an office in Chicago, Illinois.

C. FACTS

1. Lack of Independence

a. During fiscal years 2010 through 2012 (the "Relevant Period"), Cooper served as the independent public accountant for twelve broker-dealer audit clients. In connection with the 2011 audit performed for one of its broker-dealer audit clients ("Broker-Dealer A") during the Relevant Period, Cooper prepared the financial statements and/or notes to the financial statements that were filed with the Commission on Form X-17A-5.

b. During the audit for the fiscal year ended December 31, 2011, Cooper provided Broker-Dealer A with financial statement footnotes from the prior year's audit that Broker-Dealer A updated and Cooper then reviewed. Cooper also made some suggestions for the grouping of accounts to be incorporated into the financial statements.

c. In February 2012, Broker-Dealer A filed with the Commission a Form X-17A-5 Part III for the fiscal year ended December 31, 2011. Included in that filing is an audit report signed by Cooper and stating, among other things, that Cooper's audit of Broker-Dealer A was conducted "in accordance with auditing standards generally accepted in the United States."

2. Violations

a. Section 17(e)(1)(A) of the Exchange Act requires that every registered broker or dealer "annually file with the Commission a balance sheet and income statement certified by an independent public accounting firm, or by a registered public accounting firm if the firm is required to be registered under the Sarbanes-Oxley Act of 2002, prepared on a calendar or fiscal year basis, and such other financial statements (which shall, as the Commission specifies, be certified) and information concerning its financial condition as the Commission, by rule may prescribe as necessary or appropriate in the public interest or for the protection of investors."

b. Exchange Act Rule 17a-5(e)(1)(i) states: "An audit shall be conducted by a public accountant who shall be in fact independent as defined in paragraph (f)(3) of this section herein, and he shall give an opinion covering the statements filed pursuant to paragraph (d) . . . ." Exchange Act Rule 17a-5(f)(3) further states that, for such audits, "[a]n accountant shall be independent in accordance with the provisions of Rule 2-01(b) and (c) of Regulation S-X."

c. Exchange Act Rule 17a-5(g) requires that "[t]he audit shall be made in accordance with generally accepted auditing standards" and Exchange Act Rule 17a-5(i) requires that "[t]he accountant's report shall . . . [s]tate whether the audit was made in accordance with generally accepted auditing standards." Generally accepted auditing standards ("GAAS") require auditors to maintain strict independence from their audit clients; an auditor "must be free from any obligation to or interest in the client, its management or its owners." *See* Statement on Auditing Standard No. 1, Section 220.03. Accordingly, if an auditor's report states that its audit was performed in accordance with GAAS when the auditor was not independent, then it has violated Exchange Act Rule 17a-5(i). *See In the Matter of Rosenberg Rich Baker Berman & Company and Brian Zucker, CPA,* Exchange Act Release No. 69765 at p. 5 (June 14, 2013).

d. Rule 2-01(c)(4) of Regulation S-X provides that accountants are not independent if, at any point during the audit and professional engagement period, the accountant provides prohibited non-audit services to an audit client. Rule 2-01(c)(4)(i) of Regulation S-X provides that prohibited non-audit services include bookkeeping or other services related to the accounting records or financial statements of the audit client, and defines such services as:

> Any service, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including:
>
> (A) Maintaining or preparing the audit client's accounting records;
>
> (B) Preparing the audit client's financial statements that are filed with the Commission or that form the basis of financial statements filed with the Commission; or
>
> (C) Preparing or originating source data underlying the audit client's financial statements.

e. Rule 2-01(c)(4)(i) of Regulation S-X specifically prohibits an audit firm from preparing an audit client's financial statements that are filed with the Commission. In this context, preparing financial statements includes but is not limited to: aggregating line items from internal books and records to the financial statements; changing line item descriptions; drafting or editing notes to the financial statements; and converting FOCUS reports or bookkeeping software program reports into financial statements. With respect to the audit of Broker-Dealer A, Cooper engaged in one or more of the above prohibited actions, by drafting or editing the notes.

f. As a result of Cooper's conduct described above, Cooper was not independent of Broker-Dealer A under the independence criteria established by Rule 2-01(c)(4) of Regulation S-X, which Exchange Act Rule 17a-5 made applicable to the audits of broker-dealer financial statements. As the Commission explained in adopting Rule 2-01(c)(4), providing such services for an audit client "impairs the auditor's independence because the auditor will be placed in the position of auditing the firm's work when auditing the client's financial statements. . . . In addition, keeping the books is a management function, the performance of which leads to an inappropriate mutuality of interests between the auditor and the audit client." *Revision of the Commission's Auditor Independence Requirements*, Exchange Act Release No. 43602, at IV.D.4.b(i) (November 21, 2000). *See also Strengthening the Commission's Requirements Regarding Auditor Independence*, Exchange Act Release No. 47265 ("keeping the books is a management function, which also is prohibited")(January 28, 2003).

g. Cooper violated Exchange Act Rule 17a-5(i) by representing in its audit report that it had performed the audit of Broker-Dealer A's financial statements in accordance with GAAS when in fact, because of the independence impairment described above, the audit had not been performed in accordance with GAAS.

h. Exchange Act Section 17(a) and Rule 17a-5 require broker-dealers to file annual reports containing financial statements audited by independent public accountants. No showing of scienter is necessary to establish a violation of Exchange Act Section 17(a)(1). *See In the Matter of Orlando Joseph Jett*, Exchange Act Release No. 49366 at n.45 (March 5, 2004) (citing *SEC v Drexel Burham Lambert Inc.*, 837 F. Supp. 587, 610 (S.D.N.Y. 1993); *Stead v. SEC*, 444 F.2d 713, 716-17 (10th Cir. 1971), *cert denied*, 404 U.S. 1059 (1972)).

i. Under Section 21C of the Exchange Act, a person is a "cause" of another's primary violation if the person knew or should have known that his act or omission would contribute to the primary violation. Negligence is sufficient to establish "causing" liability under Section 21C when a person is alleged to have caused a primary violation that does not require scienter. *In re KPMG Peat Marwick*, Exch. Act. Rel. No. 43862 (Jan. 19, 2001), *aff'd, KPMG v. SEC*, 289 F.3d 109 (D.C. Cir. 2002).

j. Cooper caused Broker-Dealer A to violate Exchange Act Section 17(a) and Rule 17a-5. Cooper, an audit firm registered with the PCAOB and operated by a Certified Public Accountant, knew or should have known that its conduct, including incorrectly stating in an audit report that the audit was conducted in accordance with GAAS, contributed to Broker-Dealer A's violations of Exchange Act Section 17(a) and Rule 17a-5.

k. Rule 102(e) of the Commission's Rules of Practice allows the Commission to censure a person if it finds that such person has engaged in "improper professional conduct." Exchange Act § 4C(a)(2); Rule 102(e)(1)(ii). Rule 102(e) defines improper professional conduct, in part, as: "[a] single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the registered public accounting firm or associated person knows, or should know, that heightened scrutiny is warranted." Exchange Act § 4C(b)(2); Rule 102(e)(1)(iv)(B).

l. Questions regarding an auditor's independence always warrant heightened scrutiny. *See* Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57,164, 57,168 (Oct. 26, 1998) (codified at 17 C.F.R. Part 201). The Commission has defined the "highly unreasonable" standard as:

> an intermediate standard, higher than ordinary negligence but lower than the traditional definition of recklessness used in cases brought under Section 10(b) of the Exchange Act and Rule 10b-5 of the Exchange Act. The highly unreasonable standard is an objective standard. The conduct at issue is measured by the degree of the departure from professional standards and not the intent of the accountant.

Id. at 57,167; *see also In the Matter of Ernst & Young LLP*, Admin. Proc. File No. 3-10933, SEC Initial Decision Release No. 249, at 60 (Apr. 16, 2004).

m. Based on the conduct set forth above, Cooper engaged in highly unreasonable conduct that resulted in a violation of applicable professional standards when it knew or should have known that heightened scrutiny was required.

3. **Findings**

a. Based on the foregoing, the Commission finds that Cooper engaged in improper professional conduct pursuant to Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

b. Based on the foregoing, the Commission finds that Cooper committed a violation of Exchange Act Rule 17a-5(i) and caused one broker-dealer's violations of Section 17(a) and Rule 17a-5 promulgated thereunder.

4. **Respondent's Remedial Efforts and Cooperation**

In determining to accept the Offer, the Commission considered the remedial acts undertaken by Respondent and the cooperation afforded the Commission staff. As part of its remediation, Cooper has already implemented or begun to implement some of the Undertakings listed below.

5. **Undertakings**

Cooper undertakes:

a. within ninety (90) days from the date of the Order, to establish written policies and procedures, or to revise and/or supplement existing written policies and procedures, for the purpose of providing Cooper with reasonable assurance of compliance with applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement (defined to mean an engagement to provide a report – whether an audit report, an examination report, or a review report – required under Exchange Act Rule 17a-5(d)(1)(i)(C), as amended);

b. within ninety (90) days from the date of the Order, to establish a policy of ensuring training, whether internal or external, on an annual or more frequent regular basis, concerning applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement, of any Firm audit personnel who participate in any way in the planning or performing of any SEC Registered Broker-Dealer Engagement;

c. within ninety (90) days from the date of the Order and before Cooper's commencement of any SEC Registered Broker-Dealer Engagement (or, where Cooper by the date of this Order has already commenced but not completed such an engagement, before

Cooper's release of its report), to ensure training pursuant to the policy described in paragraph (5)(b) above has been provided on at least one occasion;

d. to provide a copy of the Order –

(i) within thirty (30) days from the date of the Order, to all audit personnel employed by, or associated with (as defined in PCAOB Rule 1001(p)(i)), Cooper as of the date of the Order; and

(ii) within thirty (30) days from the date of the Order, to any client of Cooper as of the date of the Order for which Cooper has performed or has been engaged to perform an SEC Registered Broker-Dealer Engagement; and

e. to certify in writing to Stephen L. Cohen, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5553, Cooper's compliance with paragraphs 5(a) through 5(d)(ii) above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. Cooper shall submit such certification within one hundred twenty (120) days from the date of the Order. Cooper shall also submit such additional evidence of and information concerning compliance as the staff of the Division of Enforcement may reasonably request.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Cooper's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Cooper is hereby censured.

B. Cooper shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-5 promulgated thereunder.

C. Cooper shall comply with the undertakings enumerated in Section (III)(C)(5) above.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar dissents as to penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73770 / December 8, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3605 / December 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16301

In the Matter of Joseph Yafeh CPA, Inc., Respondent.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Joseph Yafeh CPA, Inc. ("Respondent" or "Yafeh") pursuant to Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[2]

1 Section 4C provides, in relevant part, that:

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

2 Rule 102(e)(1)(ii) provides, in pertinent part, that:

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[3] that:

A. SUMMARY

This matter concerns violations of the Commission's auditor independence rules by Yafeh. Yafeh audited the annual financial statements that were filed with the Commission for approximately 22 broker-dealer audit clients for the fiscal years 2010, 2011, and/or 2012. For at least one of the audits of those clients during that time period, Yafeh was not independent under auditor independence criteria established by the Commission and made applicable by Exchange Act Rule 17a-5(f)(3) to audits of brokers and dealers.[4] As a result of this conduct, Yafeh engaged in improper professional conduct, violated the auditor independence rules, and caused each of the broker-dealers' failure to file an annual report audited by an independent accountant.

B. RESPONDENT

Respondent Yafeh, a professional corporation, is an accounting and auditing firm registered with the Public Company Accounting Oversight Board ("PCAOB") with its office in Los Angeles, California. Yafeh has one professional staff member, plus one administrative staff member.

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3 The findings are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

4 The provisions of Exchange Act Rule 17a-5 referred to herein are those in effect during, and applicable to, the relevant conduct. On July 30, 2013, the Commission adopted certain amendments to Rule 17a-5. *See* Broker-Dealer Reports, SEC Exchange Act Release No. 34-70073 (July 30, 2013), 78 Fed. Reg. 51910 (Aug. 21, 2013). Among other things, the amendments to Rule 17a-5 require that audits of brokers and dealers be performed in accordance with Public Company Accounting Oversight Board standards, effective for audits of fiscal years ending on or after June 1, 2014. The auditor independence requirement of Rule 2-01 of Regulation S-X applied to broker-dealer audits both before and after the July 30, 2013 amendments. At the time of the relevant conduct, prior to the amendments, that requirement was set out in Rule 17a-5(f)(3). It is now set out in Rule 17a-5(f)(1).

C. FACTS

1. Lack of Independence

a. During fiscal years 2010 through 2012 (the "Relevant Period"), Yafeh served as the independent public accountant for approximately 22 broker-dealer audit clients. In connection with at least one audit performed for each of those broker-dealer audit clients during the Relevant Period, Yafeh prepared the financial statements and/or notes to the financial statements that were filed with the Commission on Form X-17A-5.

b. For example, with respect to one of its broker-dealer clients ("Broker-Dealer A"), Yafeh audited the annual financial statements for Broker-Dealer A for the fiscal year ending 2011. During the audit, Broker-Dealer A provided Yafeh with financial statements prepared from Quickbooks accounting software. Yafeh reviewed and tested these documents, and the financial data contained therein, as part of the audit. Yafeh then utilized the information contained in these documents to create and revise a set of financial statements to be filed with the Commission. In particular, Yafeh personnel working on Yafeh computers typed and updated the new set of financial statements, including the notes to the financial statements and the cash flow statement. Yafeh then provided the set of financial statements it had prepared to Broker-Dealer A's management for approval.

c. In February 2012, Broker-Dealer A filed with the Commission a Form X-17A-5 Part III for the fiscal year ended December 31, 2011. Included in that filing is an audit report signed by Yafeh and stating, among other things, that Yafeh's audit of Broker-Dealer A was conducted "in accordance with auditing standards generally accepted in the United States of America."

d. Yafeh engaged in substantially similar conduct in connection with at least one audit for approximately 21 additional broker-dealer clients during the relevant period.

2. Violations

a. Section 17(e)(1)(A) of the Exchange Act requires that every registered broker or dealer "annually file with the Commission a balance sheet and income statement certified by an independent public accounting firm, or by a registered public accounting firm if the firm is required to be registered under the Sarbanes-Oxley Act of 2002, prepared on a calendar or fiscal year basis, and such other financial statements (which shall, as the Commission specifies, be certified) and information concerning its financial condition as the Commission, by rule may prescribe as necessary or appropriate in the public interest or for the protection of investors."

b. Exchange Act Rule 17a-5(e)(1)(i) states: "An audit shall be conducted by a public accountant who shall be in fact independent as defined in paragraph (f)(3) of this section herein, and he shall give an opinion covering the statements filed pursuant to paragraph (d) . . . ." Exchange Act Rule 17a-5(f)(3) further states that, for such audits, "[a]n accountant shall be independent in accordance with the provisions of Rule 2-01(b) and (c) of Regulation S-X."

c. Exchange Act Rule 17a-5(g) requires that "[t]he audit shall be made in accordance with generally accepted auditing standards" and Exchange Act Rule 17a-5(i) requires that "[t]he accountant's report shall . . . [s]tate whether the audit was made in accordance with generally accepted auditing standards." Generally accepted auditing standards ("GAAS") require auditors to maintain strict independence from their audit clients; an auditor "must be free from any obligation to or interest in the client, its management or its owners." *See* Statement on Auditing Standard No. 1, Section 220.03. Accordingly, if an auditor's report states that its audit was performed in accordance with GAAS when the auditor was not independent, then it has violated Exchange Act Rule 17a-5(i). *See In the Matter of Rosenberg Rich Baker Berman & Company and Brian Zucker, CPA,* Exchange Act Release No. 69765 at p. 5 (June 14, 2013).

d. Rule 2-01(c)(4) of Regulation S-X provides that accountants are not independent if, at any point during the audit and professional engagement period, the accountant provides prohibited non-audit services to an audit client. Rule 2-01(c)(4)(i) of Regulation S-X provides that prohibited non-audit services include bookkeeping or other services related to the accounting records or financial statements of the audit client, and defines such services as:

> Any service, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including:
>
> (A) Maintaining or preparing the audit client's accounting records;
>
> (B) Preparing the audit client's financial statements that are filed with the Commission or that form the basis of financial statements filed with the Commission; or
>
> (C) Preparing or originating source data underlying the audit client's financial statements.

e. Rule 2-01(c)(4)(i) of Regulation S-X specifically prohibits an audit firm from preparing an audit client's financial statements that are filed with the Commission. In this context, preparing financial statements includes but is not limited to: aggregating line items from internal books and records to the financial statements; changing line item descriptions; drafting or editing notes to the financial statements; and converting FOCUS reports or bookkeeping software program reports into financial statements. With respect to the audit of Broker-Dealer A and the additional audits in which Yafeh engaged in substantially similar conduct, Yafeh engaged in one or more of the above prohibited actions.

f. As a result of Yafeh's conduct in preparing the financial statements, including the notes thereto, Yafeh was not independent of its broker-dealer audit clients under the independence criteria established by Rule 2-01(c)(4) of Regulation S-X, which Exchange Act Rule 17a-5 made applicable to the audits of broker-dealer financial statements. As the Commission explained in adopting Rule 2-01(c)(4), providing such services for an audit client "impairs the auditor's independence because the auditor will be placed in the position of auditing the firm's work when auditing the client's financial statements. . . . In addition, keeping the books is a management function, the performance of which leads to an inappropriate mutuality of interests between the auditor and the audit client." *Revision of the Commission's Auditor Independence Requirements*, Exchange Act Release No. 43602, at IV.D.4.b(i) (November 21, 2000). *See also Strengthening the Commission's Requirements Regarding Auditor Independence*, Exchange Act Release No. 47265 ("keeping the books is a management function, which also is prohibited")(January 28, 2003).

g. Yafeh violated Exchange Act Rule 17a-5(i) by representing in its audit report that it had performed the audits of the broker-dealers' financial statements in accordance with GAAS when in fact, because of the independence impairment described above, the audit had not been performed in accordance with GAAS.

h. Exchange Act Section 17(a) and Rule 17a-5 require broker-dealers to file annual reports containing financial statements audited by independent public accountants. No showing of scienter is necessary to establish a violation of Exchange Act Section 17(a). *See In the Matter of Orlando Joseph Jett*, Exchange Act Release No. 49366 at n.45 (March 5, 2004) (citing *SEC v Drexel Burham Lambert Inc.*, 837 F. Supp. 587, 610 (S.D.N.Y. 1993); *Stead v. SEC*, 444 F.2d 713, 716-17 (10^{th} Cir. 1971), *cert denied*, 404 U.S. 1059 (1972)).

i. Under Section 21C of the Exchange Act, a person is a "cause" of another's primary violation if the person knew or should have known that his act or omission would contribute to the primary violation. Negligence is sufficient to establish "causing" liability under Section 21C when a person is alleged to have caused a primary violation that does not require scienter. *In re KPMG Peat Marwick*, Exch. Act. Rel. No. 43862 (Jan. 19, 2001), *aff'd, KPMG v. SEC*, 289 F.3d 109 (D.C. Cir. 2002).

j. Yafeh caused its broker-dealer audit clients to violate Exchange Act Section 17(a) and Rule 17a-5. Respondent, an audit firm registered with the PCAOB and operated by a Certified Public Accountant, knew or should have known that its conduct, including incorrectly stating in audit reports that the audits were conducted in accordance with GAAS, contributed to its audit clients' violations of Exchange Act Section 17(a) and Rule 17a-5.

k. Rule 102(e) of the Commission's Rules of Practice allows the Commission to censure a person if it finds that such person has engaged in "improper professional conduct." Exchange Act § 4C(a)(2); Rule 102(e)(1)(ii). Rule 102(e) defines improper professional conduct, in part, as: "[a] single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the registered public accounting firm or associated person knows, or should know, that heightened scrutiny is warranted." Exchange Act § 4C(b)(2); Rule 102(e)(1)(iv)(B).

l. Questions regarding an auditor's independence always warrant heightened scrutiny. *See* Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57,164, 57168 (Oct. 26, 1998) (codified at 17 C.F.R. Part 201). The Commission has defined the "highly unreasonable" standard as:

> an intermediate standard, higher than ordinary negligence but lower than the traditional definition of recklessness used in cases brought under Section 10(b) of the Exchange Act and Rule 10b-5 of the Exchange Act. The highly unreasonable standard is an objective

standard. The conduct at issue is measured by the degree of the departure from professional standards and not the intent of the accountant.

Id. at 57,167; *see also In the Matter of Ernst & Young LLP, Admin. Proc. File No. 3-10933, SEC Initial Decision Release No. 249, at 60 (Apr. 16, 2004).*

m. Based on the conduct set forth above, Yafeh engaged in highly unreasonable conduct that resulted in violations of applicable professional standards when it knew or should have known that heightened scrutiny was required.

3. **Findings**

a. Based on the foregoing, the Commission finds that Yafeh engaged in improper professional conduct pursuant to Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

b. Based on the foregoing, the Commission finds that Yafeh committed violations of Exchange Act Rule 17a-5(i) and caused approximately 22 broker-dealers' violations of Section 17(a) and Rule 17a-5 promulgated thereunder.

4. **Respondent's Remedial Efforts and Cooperation**

In determining to accept the Offer, the Commission considered the remedial acts undertaken by Respondent and the cooperation afforded the Commission staff. As part of its remediation, Respondent has already implemented or begun to implement some of the Undertakings listed below.

5. **Undertakings**

Yafeh undertakes:

a. within ninety (90) days from the date of the Order, to establish written policies and procedures, or to revise and/or supplement existing written policies and procedures, for the purpose of providing Yafeh with reasonable assurance of compliance with applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement (defined to mean an engagement to provide a report – whether an audit report, an examination report, or a review report – required under Exchange Act Rule 17a-5(d)(1)(i)(C), as amended);

b. within ninety (90) days from the date of the Order, to establish a policy of ensuring training, whether internal or external, on an annual or more frequent regular basis, concerning applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement, of any Firm audit personnel who participate in any way in the planning or performing of any SEC Registered Broker-Dealer Engagement;

c. within ninety (90) days from the date of the Order and before Yafeh's commencement of any SEC Registered Broker-Dealer Engagement (or, where Yafeh by the date of this Order has already commenced but not completed such an engagement, before Yafeh's release of its report), to ensure training pursuant to the policy described in paragraph (5)(b) above has been provided on at least one occasion;

d. to provide a copy of the Order –

(i) within thirty (30) days from the date of the Order, to all audit personnel employed by, or associated with (as defined in PCAOB Rule 1001(p)(i)), Yafeh as of the date of the Order; and

(ii) within thirty (30) days from the date of the Order, to any client of Yafeh as of the date of the Order for which Yafeh has performed or has been engaged to perform an SEC Registered Broker-Dealer Engagement; and

e. to certify in writing to Stephen L. Cohen, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5553, Doe's compliance with paragraphs 5(a) through 5(d)(ii). The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. Yafeh shall submit such certification within one hundred twenty (120) days from the date of the Order. Yafeh shall also submit such additional evidence of and information concerning compliance as the staff of the Division of Enforcement may reasonably request.

IV.

On the basis of the foregoing, Respondent hereby consents to the entry of an Order by the Commission that:

A. Yafeh is hereby censured.

B. Yafeh shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-5 promulgated thereunder.

C. Yafeh shall comply with the undertakings enumerated in Section (III)(C)(5) above.

D. Yafeh shall pay civil penalties of $20,000 to the Securities and Exchange Commission. Payment shall be made in the following installments: $10,000 within ten days of the entry of this Order and $10,000 in three quarterly installments of $3,333.33 beginning 120 days after the entry of the Order and continuing thereafter at 120-day intervals until the three quarterly payment schedule is complete. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Yafeh as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Stephen L. Cohen, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5553.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73772 / December 8, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3607 / December 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16303

In the Matter of **Brace & Associates, PLLC,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Brace & Associates, PLLC ("Respondent" or "Brace") pursuant to Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[2]

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1 Section 4C provides, in relevant part, that:

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

2 Rule 102(e)(1)(ii) provides, in pertinent part, that:

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[3] that:

A. SUMMARY

This matter concerns violations of the Commission's auditor independence rules by Brace. Brace audited the annual financial statements that were filed with the Commission for 20 broker-dealer audit clients for the fiscal years 2010 through 2012. For at least one audit for two of these broker-dealer audit clients during that time period, Brace was not independent under auditor independence criteria established by the Commission and made applicable by Exchange Act Rule 17a-5(f)(3) to audits of brokers and dealers.[4] As a result of this conduct, Brace engaged in improper professional conduct, violated the auditor independence rules, and caused each of the broker-dealers' failure to file an annual report audited by an independent accountant.

B. RESPONDENT

Respondent Brace, a professional company, is an accounting and auditing firm registered with the Public Company Accounting Oversight Board ("PCAOB") with its office in Londonderry, New Hampshire. Brace is a solo practitioner with no administrative staff.

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3 The findings are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

4 The provisions of Exchange Act Rule 17a-5 referred to herein are those in effect during, and applicable to, the relevant conduct. On July 30, 2013, the Commission adopted certain amendments to Rule 17a-5. *See* Broker-Dealer Reports, SEC Exchange Act Release No. 34-70073 (July 30, 2013), 78 Fed. Reg. 51910 (Aug. 21, 2013). Among other things, the amendments to Rule 17a-5 require that audits of brokers and dealers be performed in accordance with Public Company Accounting Oversight Board standards, effective for audits of fiscal years ending on or after June 1, 2014. The auditor independence requirement of Rule 2-01 of Regulation S-X applied to broker-dealer audits both before and after the July 30, 2013 amendments. At the time of the relevant conduct, prior to the amendments, that requirement was set out in Rule 17a-5(f)(3). It is now set out in Rule 17a-5(f)(1).

C. FACTS

1. Lack of Independence

a. During fiscal years 2010 through 2012 (the "Relevant Period"), Brace served as the independent public accountant for twenty broker-dealer audit clients. In connection with at least one audit performed for two of those broker-dealer audit clients during the Relevant Period, Brace prepared the financial statements and/or notes to the financial statements that were filed with the Commission on Form X-17A-5.

b. For example, with respect to one of its broker-dealer clients ("Broker-Dealer A"), Brace audited the annual financial statements for Broker-Dealer A for the fiscal year ending 2012. During the audit, Broker-Dealer A provided Brace with accounting records and source data. Brace reviewed and tested these ledgers and accounts contained therein, as part of the audit. Brace then utilized the information contained in these documents to create and revise a set of financial statements to be filed with the Commission. In particular, Brace typed and updated the new set of financial statements, including the notes to the financial statements and the cash flow statement. Brace then provided the financial statements it had prepared to Broker-Dealer A's management for approval.

c. In June 2012, Broker-Dealer A filed with the Commission a Form X-17A-5 Part III for the fiscal year ended March 31, 2012. Included in that filing is an audit report signed by Brace and stating, among other things, that Brace's audit of Broker-Dealer A was conducted "in accordance with auditing standards generally accepted in the United States of America."

d. Brace engaged in substantially similar conduct in connection with at least one audit for one additional broker-dealer client during the Relevant Period.

2. <u>Violations</u>

a. Section 17(e)(1)(A) of the Exchange Act requires that every registered broker or dealer "annually file with the Commission a balance sheet and income statement certified by an independent public accounting firm, or by a registered public accounting firm if the firm is required to be registered under the Sarbanes-Oxley Act of 2002, prepared on a calendar or fiscal year basis, and such other financial statements (which shall, as the Commission specifies, be certified) and information concerning its financial condition as the Commission, by rule may prescribe as necessary or appropriate in the public interest or for the protection of investors."

b. Exchange Act Rule 17a-5(e)(1)(i) states: "An audit shall be conducted by a public accountant who shall be in fact independent as defined in paragraph (f)(3) of this section herein, and he shall give an opinion covering the statements filed pursuant to paragraph (d) . . . ." Exchange Act Rule 17a-5(f)(3) further states that, for such audits, "[a]n accountant shall be independent in accordance with the provisions of Rule 2-01(b) and (c) of Regulation S-X."

c. Exchange Act Rule 17a-5(g) requires that "[t]he audit shall be made in accordance with generally accepted auditing standards" and Exchange Act Rule 17a-5(i) requires that "[t]he accountant's report shall . . . [s]tate whether the audit was made in accordance with generally accepted auditing standards." Generally accepted auditing standards ("GAAS") require auditors to maintain strict independence from their audit clients; an auditor "must be free from any obligation to or interest in the client, its management or its owners." *See* Statement on Auditing Standard No. 1, Section 220.03. Accordingly, if an auditor's report states that its audit was performed in accordance with GAAS when the auditor was not independent, then it has violated Exchange Act Rule 17a-5(i). *See In the Matter of Rosenberg Rich Baker Berman & Company and Brian Zucker, CPA*, Exchange Act Release No. 69765 at p. 5 (June 14, 2013).

d. Rule 2-01(c)(4) of Regulation S-X provides that accountants are not independent if, at any point during the audit and professional engagement period, the accountant provides prohibited non-audit services to an audit client. Rule 2-01(c)(4)(i) of Regulation S-X provides that prohibited non-audit services include bookkeeping or other services related to the accounting records or financial statements of the audit client, and defines such services as:

> Any service, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including:
>
> (A) Maintaining or preparing the audit client's accounting records;
>
> (B) Preparing the audit client's financial statements that are filed with the Commission or that form the basis of financial statements filed with the Commission; or
>
> (C) Preparing or originating source data underlying the audit client's financial statements.

e. Rule 2-01(c)(4)(i) of Regulation S-X specifically prohibits an audit firm from preparing an audit client's financial statements that are filed with the Commission. In this context, preparing financial statements includes but is not limited to: aggregating line items from internal books and records to the financial statements; changing line item descriptions; drafting or editing notes to the financial statements; and converting FOCUS reports or bookkeeping software program reports into financial statements. With respect to the audit of Broker-Dealer A and one other broker-dealer client, Brace engaged in one or more of the above prohibited actions.

f. As a result of Brace's conduct in preparing the financial statements, including the notes thereto, Brace was not independent of its broker-dealer audit clients under the independence criteria established by Rule 2-01(c)(4) of Regulation S-X, which Exchange Act Rule 17a-5 made applicable to the audits of broker-dealer financial statements. As the Commission explained in adopting Rule 2-01(c)(4), providing such services for an audit client "impairs the auditor's independence because the auditor will be placed in the position of auditing the firm's work when auditing the client's financial statements. . . . In addition, keeping the books is a management function, the performance of which leads to an inappropriate mutuality of interests between the auditor and the audit client." *Revision of the Commission's Auditor Independence Requirements*, Exchange Act Release No. 43602, at IV.D.4.b(i) (November 21, 2000). *See also Strengthening the*

Commission's Requirements Regarding Auditor Independence, Exchange Act Release No. 47265 ("keeping the books is a management function, which also is prohibited")(January 28, 2003).

g. Brace violated Exchange Act Rule 17a-5(i) by representing in its audit report that it had performed the audits of the broker-dealers' financial statements in accordance with GAAS when in fact, because of the independence impairment described above, the audit had not been performed in accordance with GAAS.

h. Exchange Act Section 17(a) and Rule 17a-5 require broker-dealers to file annual reports containing financial statements audited by independent public accountants. No showing of scienter is necessary to establish a violation of Exchange Act Section 17(a). *See In the Matter of Orlando Joseph Jett*, Exchange Act Release No. 49366 at n.45 (March 5, 2004) (citing *SEC v Drexel Burham Lambert Inc.*, 837 F. Supp. 587, 610 (S.D.N.Y. 1993); *Stead v. SEC*, 444 F.2d 713, 716-17 (10th Cir. 1971), *cert denied*, 404 U.S. 1059 (1972)).

i. Under Section 21C of the Exchange Act, a person is a "cause" of another's primary violation if the person knew or should have known that his act or omission would contribute to the primary violation. Negligence is sufficient to establish "causing" liability under Section 21C when a person is alleged to have caused a primary violation that does not require scienter. *In re KPMG Peat Marwick*, Exch. Act. Rel. No. 43862 (Jan. 19, 2001), *aff'd, KPMG v. SEC*, 289 F.3d 109 (D.C. Cir. 2002).

j. Brace caused its broker-dealer audit clients to violate Exchange Act Section 17(a) and Rule 17a-5. Respondent, an audit firm registered with the PCAOB and operated by a Certified Public Accountant, knew or should have known that its conduct, including incorrectly stating in audit reports that the audits were conducted in accordance with GAAS, contributed to its audit clients' violations of Exchange Act Section 17(a) and Rule 17a-5.

k. Rule 102(e) of the Commission's Rules of Practice allows the Commission to censure a person if it finds that such person has engaged in "improper professional conduct." Exchange Act § 4C(a)(2); Rule 102(e)(1)(ii). Rule 102(e) defines improper professional conduct, in part, as: "[a] single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the registered public accounting firm or associated person knows, or should know, that heightened scrutiny is warranted." Exchange Act § 4C(b)(2); Rule 102(e)(1)(iv)(B).

l. Questions regarding an auditor's independence always warrant heightened scrutiny. *See* Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57,164, 57,168 (Oct. 26, 1998) (codified at 17 C.F.R. Part 201). The Commission has defined the "highly unreasonable" standard as:

> an intermediate standard, higher than ordinary negligence but lower than the traditional definition of recklessness used in cases brought under Section 10(b) of the Exchange Act and Rule 10b-5 of the Exchange Act. The highly unreasonable standard is an objective standard. The conduct at issue is measured by the degree of the departure from professional standards and not the intent of the accountant.

Id. at 57,167; *see also In the Matter of Ernst & Young LLP*, Admin. Proc. File No. 3-10933, SEC Initial Decision Release No. 249, at 60 (Apr. 16, 2004).

m. Based on the conduct set forth above, Brace engaged in highly unreasonable conduct that resulted in violations of applicable professional standards when it knew or should have known that heightened scrutiny was required.

3. **Findings**

a. Based on the foregoing, the Commission finds that Brace engaged in improper professional conduct pursuant to Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

b. Based on the foregoing, the Commission finds that Brace committed violations of Exchange Act Rule 17a-5(i) and caused two broker-dealers' violations of Section 17(a) and Rule 17a-5 promulgated thereunder.

4. **Respondent's Remedial Efforts and Cooperation**

In determining to accept the Offer, the Commission considered the remedial acts undertaken by Respondent and the cooperation afforded the Commission staff. As part of its remediation, Respondent has already implemented or begun to implement some of the Undertakings listed below.

5. **Undertakings**

Brace undertakes:

a. within ninety (90) days from the date of the Order, to establish written policies and procedures, or to revise and/or supplement existing written policies and procedures, for the purpose of providing Brace with reasonable assurance of compliance with applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement (defined to mean an engagement to provide a report – whether an audit report, an examination report, or a review report – required under Exchange Act Rule 17a-5(d)(1)(i)(C), as amended);

b. within ninety (90) days from the date of the Order, to establish a policy of ensuring training, whether internal or external, on an annual or more frequent regular basis, concerning applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement, of any Firm audit personnel who participate in any way in the planning or performing of any SEC Registered Broker-Dealer Engagement;

c. within ninety (90) days from the date of the Order and before Brace's commencement of any SEC Registered Broker-Dealer Engagement (or, where Brace by the date of this Order has already commenced but not completed such an engagement, before Brace's release of its report), to ensure training pursuant to the policy described in paragraph (5)(b) above has been provided on at least one occasion;

d. to provide a copy of the Order –

(i) within thirty (30) days from the date of the Order, to all audit personnel employed by, or associated with (as defined in PCAOB Rule 1001(p)(i)), Brace as of the date of the Order;

(ii) within thirty (30) days from the date of the Order, to any client of Brace as of the date of the Order for which Brace has performed or has been engaged to perform an SEC Registered Broker-Dealer Engagement; and

e. to certify in writing to Stephen L. Cohen, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5553, Brace's compliance with paragraphs 5(a) through 5(d)(ii) above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. Brace shall submit such certification within one hundred twenty (120) days from the date of the Order. Brace shall also submit such additional evidence of and information concerning compliance as the staff of the Division of Enforcement may reasonably request.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Brace's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Brace is hereby censured.

B. Brace shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-5 promulgated thereunder.

C. Brace shall comply with the undertakings enumerated in Section (III)(C)(5) above.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar dissent as to penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73771 / December 8, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3606 / December 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16302

In the Matter of **Lally & Co., LLC,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Lally & Co., LLC ("Respondent" or "Lally") pursuant to Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[2]

1 Section 4C provides, in relevant part, that:

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

2 Rule 102(e)(1)(ii) provides, in pertinent part, that:

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[3] that:

A. SUMMARY

This matter concerns violations of the Commission's auditor independence rules by Lally. Lally audited the annual financial statements that were filed with the Commission for ten broker-dealer audit clients for the fiscal years 2010, 2011, and/or 2012. For at least one of the audits of seven of those clients during that time period, Lally was not independent under auditor independence criteria established by the Commission and made applicable by Exchange Act Rule 17a-5(f)(3) to audits of brokers and dealers.[4] As a result of this conduct, Lally engaged in improper professional conduct, violated the auditor independence rules, and caused each of the broker-dealers' failure to file an annual report audited by an independent accountant.

B. RESPONDENT

Respondent Lally, a limited liability company, is an accounting and auditing firm registered with the Public Company Accounting Oversight Board ("PCAOB") with its office in Pittsburgh, Pennsylvania. Lally has thirty professional staff plus six administrative staff.

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[3] The findings are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

[4] The provisions of Exchange Act Rule 17a-5 referred to herein are those in effect during, and applicable to, the relevant conduct. On July 30, 2013, the Commission adopted certain amendments to Rule 17a-5. *See* Broker-Dealer Reports, SEC Exchange Act Release No. 34-70073 (July 30, 2013), 78 Fed. Reg. 51910 (Aug. 21, 2013). Among other things, the amendments to Rule 17a-5 require that audits of brokers and dealers be performed in accordance with Public Company Accounting Oversight Board standards, effective for audits of fiscal years ending on or after June 1, 2014. The auditor independence requirement of Rule 2-01 of Regulation S-X applied to broker-dealer audits both before and after the July 30, 2013 amendments. At the time of the relevant conduct, prior to the amendments, that requirement was set out in Rule 17a-5(f)(3). It is now set out in Rule 17a-5(f)(1).

C. FACTS

1. Lack of Independence

a. During fiscal years 2010 through 2012 (the "Relevant Period"), Lally served as the independent public accountant for ten broker-dealer audit clients. In connection with at least one audit performed for seven of its broker-dealer audit clients during the Relevant Period, Lally prepared the financial statements and/or notes to the financial statements that were filed with the Commission on Form X-17A-5.

b. For example, with respect to one of its broker-dealer audit clients ("Broker-Dealer A"), Lally's staff entered the client's trial balance using data derived from its client's Quickbook reports and uploaded the reports into Lally's paperless engagement software in order to produce the financial statements and notes to the financial statements that Broker-Dealer A filed with the Commission on Form X-17A-5. Lally reviewed and tested these documents, and the financial data contained therein, as part of the audit. Lally then utilized the information contained in these documents to create and revise a set of financial statements to be filed with the Commission. In particular, Lally personnel working on Lally engagement software updated the new set of financial statements, including the notes to the financial statements and the cash flow statement. Lally then provided the set of financial statements it had prepared to Broker-Dealer A's management for approval.

c. In February 2012, Broker-Dealer A filed with the Commission a Form X-17A-5 Part III for the fiscal year ended December 31, 2011. Included in that filing is an audit report signed by Lally stating, among other things, that Lally's audit of Broker-Dealer A was conducted "in accordance with auditing standards generally accepted in the United States of America."

d. Lally engaged in substantially similar conduct in connection with at least one audit for six additional broker-dealer clients during the Relevant Period.

2. Violations

a. Section 17(e)(1)(A) of the Exchange Act requires that every registered broker or dealer "annually file with the Commission a balance sheet and income statement certified by an independent public accounting firm, or by a registered public accounting firm if the firm is required to be registered under the Sarbanes-Oxley Act of 2002, prepared on a calendar or fiscal year basis, and such other financial statements (which shall, as the Commission specifies, be certified) and information concerning its financial condition as the Commission, by rule may prescribe as necessary or appropriate in the public interest or for the protection of investors."

b. Exchange Act Rule 17a-5(e)(1)(i) states: "An audit shall be conducted by a public accountant who shall be in fact independent as defined in paragraph (f)(3) of this section herein, and he shall give an opinion covering the statements filed pursuant to paragraph (d) . . . ." Exchange Act Rule 17a-5(f)(3) further states that, for such audits, "[a]n accountant shall be independent in accordance with the provisions of Rule 2-01(b) and (c) of Regulation S-X."

c. Exchange Act Rule 17a-5(g) requires that "[t]he audit shall be made in accordance with generally accepted auditing standards" and Exchange Act Rule 17a-5(i) requires that "[t]he accountant's report shall . . . [s]tate whether the audit was made in accordance with generally accepted auditing standards." Generally accepted auditing standards ("GAAS") require auditors to maintain strict independence from their audit clients; an auditor "must be free from any obligation to or interest in the client, its management or its owners." *See* Statement on Auditing Standard No. 1, Section 220.03. Accordingly, if an auditor's report states that its audit was performed in accordance with GAAS when the auditor was not independent, then it has violated Exchange Act Rule 17a-5(i). *See In the Matter of Rosenberg Rich Baker Berman & Company and Brian Zucker, CPA,* Exchange Act Release No. 69765 at p. 5 (June 14, 2013).

d. Rule 2-01(c)(4) of Regulation S-X provides that accountants are not independent if, at any point during the audit and professional engagement period, the accountant provides prohibited non-audit services to an audit client. Rule 2-01(c)(4)(i) of Regulation S-X provides that prohibited non-audit services include bookkeeping or other services related to the accounting records or financial statements of the audit client, and defines such services as:

> Any service, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including:
>
> (A) Maintaining or preparing the audit client's accounting records;
>
> (B) Preparing the audit client's financial statements that are filed with the Commission or that form the basis of financial statements filed with the Commission; or
>
> (C) Preparing or originating source data underlying the audit client's financial statements.

e. Rule 2-01(c)(4)(i) of Regulation S-X specifically prohibits an audit firm from preparing an audit client's financial statements that are filed with the Commission. In this context, preparing financial statements includes but is not limited to: aggregating line items from internal books and records to the financial statements; changing line item descriptions; drafting or editing notes to the financial statements; and converting FOCUS reports or bookkeeping software program reports into financial statements. With respect to the audit of Broker-Dealer A and the additional audits in which Lally engaged in substantially similar conduct, Lally engaged in one or more of the above prohibited actions.

f. As a result of Lally's conduct in preparing the financial statements, including the notes thereto, Lally was not independent of its broker-dealer audit clients under the independence criteria established by Rule 2-01(c)(4) of Regulation S-X, which Exchange Act Rule 17a-5 made applicable to the audits of broker-dealer financial statements. As the Commission explained in adopting Rule 2-01(c)(4), providing such services for an audit client "impairs the auditor's independence because the auditor will be placed in the position of auditing the firm's work when auditing the client's financial statements. . . . In addition, keeping the books is a management function, the performance of which leads to an inappropriate mutuality of interests between the auditor and the audit client." *Revision of the Commission's Auditor Independence Requirements*, Exchange Act Release No. 43602, at IV.D.4.b(i) (November 21, 2000). *See also Strengthening the Commission's Requirements Regarding Auditor Independence*, Exchange Act Release No. 47265 ("keeping the books is a management function, which also is prohibited")(January 28, 2003).

g. Lally violated Exchange Act Rule 17a-5(i) by representing in its audit report that it had performed the audits of the broker-dealers' financial statements in accordance with GAAS when in fact, because of the independence impairment described above, the audit had not been performed in accordance with GAAS.

h. Exchange Act Section 17(a) and Rule 17a-5 require broker-dealers to file annual reports containing financial statements audited by independent public accountants. No showing of scienter is necessary to establish a violation of Exchange Act Section 17(a). *See In the Matter of Orlando Joseph Jett*, Exchange Act Release No. 49366 at n.45 (March 5, 2004) (citing *SEC v Drexel Burham Lambert Inc.*, 837 F. Supp. 587, 610 (S.D.N.Y. 1993); *Stead v. SEC*, 444 F.2d 713, 716-17 (10th Cir. 1971), *cert denied*, 404 U.S. 1059 (1972)).

i. Under Section 21C of the Exchange Act, a person is a "cause" of another's primary violation if the person knew or should have known that his act or omission would contribute to the primary violation. Negligence is sufficient to establish "causing" liability under Section 21C when a person is alleged to have caused a primary violation that does not require scienter. *In re KPMG Peat Marwick*, Exch. Act. Rel. No. 43862 (Jan. 19, 2001), *aff'd, KPMG v. SEC*, 289 F.3d 109 (D.C. Cir. 2002).

j. Lally caused its broker-dealer audit clients to violate Exchange Act Section 17(a) and Rule 17a-5. Respondent, an audit firm registered with the PCAOB and operated by a Certified Public Accountant, knew or should have known that its conduct, including incorrectly stating in audit reports that the audits were conducted in accordance with GAAS, contributed to its audit clients' violations of Exchange Act Section 17(a) and Rule 17a-5.

k. Rule 102(e) of the Commission's Rules of Practice allows the Commission to censure a person if it finds that such person has engaged in "improper professional conduct." Exchange Act § 4C(a)(2); Rule 102(e)(1)(ii). Rule 102(e) defines improper professional conduct, in part, as: "[a] single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the registered public accounting firm or associated person knows, or should know, that heightened scrutiny is warranted." Exchange Act § 4C(b)(2); Rule 102(e)(1)(iv)(B).

l. Questions regarding an auditor's independence always warrant heightened scrutiny. *See* Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57,164, 57,168 (Oct. 26, 1998) (codified at 17 C.F.R. Part 201). The Commission has defined the "highly unreasonable" standard as:

> an intermediate standard, higher than ordinary negligence but lower than the traditional definition of recklessness used in cases brought under Section 10(b) of the Exchange Act

and Rule 10b-5 of the Exchange Act. The highly unreasonable standard is an objective standard. The conduct at issue is measured by the degree of the departure from professional standards and not the intent of the accountant.

Id. at 57,167; *see also In the Matter of Ernst & Young LLP, Admin. Proc. File No. 3-10933, SEC Initial Decision Release No. 249, at 60 (Apr. 16, 2004)*

m. Based on the conduct set forth above, Lally engaged in highly unreasonable conduct that resulted in violations of applicable professional standards when it knew or should have known that heightened scrutiny was required.

3. Findings

a. Based on the foregoing, the Commission finds that Lally engaged in improper professional conduct pursuant to Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

b. Based on the foregoing, the Commission finds that Lally committed violations of Exchange Act Rule 17a-5(i) and caused seven broker-dealers' violations of Section 17(a) and Rule 17a-5 promulgated thereunder.

4. Respondent's Remedial Efforts and Cooperation

In determining to accept the Offer, the Commission considered the remedial acts undertaken by Respondent and the cooperation afforded the Commission staff. As part of its remediation, Respondent has already implemented or begun to implement some of the Undertakings listed below.

5. Undertakings

Lally undertakes:

a. within ninety (90) days from the date of the Order, to establish written policies and procedures, or to revise and/or supplement existing written policies and procedures, for the purpose of providing Lally with reasonable assurance of compliance with applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement (defined to mean an engagement to provide a report – whether an audit report, an examination report, or a review report – required under Exchange Act Rule 17a-5(d)(1)(i)(C), as amended);

b. within ninety (90) days from the date of the Order, to establish a policy of ensuring training, whether internal or external, on an annual or more frequent regular basis, concerning applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement, of any Firm audit personnel who participate in any way in the planning or performing of any SEC Registered Broker-Dealer Engagement;

c. within ninety (90) days from the date of the Order and before Lally's commencement of any SEC Registered Broker-Dealer Engagement (or, where Lally by the date of this Order has already commenced but not completed such an engagement, before Lally's release of its report), to ensure training pursuant to the policy described in paragraph (5)(b) above has been provided on at least one occasion;

d. to provide a copy of the Order –

(i) within thirty (30) days from the date of the Order, to all audit personnel employed by, or associated with (as defined in PCAOB Rule 1001(p)(i)), Lally as of the date of the Order; and

(ii) within thirty (30) days from the date of the Order, to any client of Lally as of the date of the Order for which Lally has performed or has been engaged to perform an SEC Registered Broker-Dealer Engagement;

e. within ninety (90) days from the date of the Order, to designate and maintain at least one partner (the "Independence Partner") in its national office or headquarters with responsibility for monitoring Lally's compliance with the SEC's auditor independence rules, including without limitation, the adoption, implementation and oversight of policies and procedures designed to provide Lally with reasonable assurance of such compliance;

f. within ninety (90) days from the date of the Order, to adopt and implement written procedures to provide reasonable assurance that prohibited bookkeeping services will not be provided in connection with any SEC Registered Broker-Dealer Engagement, including procedures requiring Lally to complete, on an annual basis, a client continuance form for each SEC Registered Broker-Dealer Engagement, which shall contain an assessment of risks and a listing of non-audit services being provided, and procedures requiring Lally's Independence Partner to monitor the annual completion and review of client continuance forms for all SEC Registered Broker-Dealer Engagements as well as the annual review of such other documents, forms or other information sufficient to determine whether any prohibited bookkeeping services are being provided in connection with any SEC Registered Broker-Dealer Engagements; and

g. to certify in writing to Stephen L. Cohen, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5553, Lally's compliance with paragraphs 5(a) through 5(f) above. The certification, which shall be signed by the Independence Partner, shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. Lally shall submit such certification within one hundred twenty (120) days from the date of the Order. Lally shall also submit such additional evidence of and information concerning compliance as the staff of the Division of Enforcement may reasonably request.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Lally's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Lally is hereby censured.

B. Lally shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-5 promulgated thereunder.

C. Lally shall comply with the undertakings enumerated in Section (III)(C)(5) above.

D. Lally shall within ten days of the entry of this Order pay a civil penalty of $10,000 to the Securities and Exchange Commission. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

> Enterprise Services Center
> Accounts Receivable Branch
> HQ Bldg., Room 181, AMZ-341
> 6500 South MacArthur Boulevard
> Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Lally as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Stephen L. Cohen, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5553.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar
dissent as to penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73773 / December 8, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3608 / December 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16304

In the Matter of

Boros & Farrington
Accountancy Corporation,

Respondent.

ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Boros & Farrington Accountancy Corporation ("Boros & Farrington" or "Respondent") pursuant to Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[2]

[1] Section 4C provides, in relevant part, that:

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this the Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[3] that:

A. SUMMARY

This matter concerns violations of the Commission's auditor independence rules by Boros & Farrington. Boros & Farrington audited the annual financial statements that were filed with the Commission for 26 broker-dealer audit clients for the fiscal years 2010, 2011, and/or 2012. For at least one audit of each of these broker-dealer audit clients, Boros & Farrington was not independent under auditor independence criteria established by the Commission and made applicable by Exchange Act Rule 17a-5(f)(3) to audits of brokers and dealers.[4] As a result of this conduct, Boros & Farrington engaged in improper professional conduct, violated the auditor independence rules,

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2 Rule 102(e)(1)(ii) provides, in relevant part, that:

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

3 The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

4 The provisions of Exchange Act Rule 17a-5 referred to herein are those in effect during, and applicable to, the relevant conduct. On July 30, 2013, the Commission adopted certain amendments to Rule 17a-5. *See* Broker-Dealer Reports, SEC Exchange Act Release No. 34-70073 (July 30, 2013), 78 Fed. Reg. 51910 (Aug. 21, 2013). Among other things, the amendments to Rule 17a-5 require that audits of brokers and dealers be performed in accordance with Public Company Accounting Oversight Board standards, effective for audits of fiscal years ending on or after June 1, 2014. The auditor independence requirement of Rule 2-01 of Regulation S-X applied to broker-dealer audits both before and after the July 30, 2013 amendments. At the time of the relevant conduct, prior to the amendments, that requirement was set out in Rule 17a-5(f)(3). It is now set out in Rule 17a-5(f)(1).

and caused each of the broker-dealers' failure to file an annual report audited by an independent accountant.

B. RESPONDENT

Respondent Boros & Farrington, a professional corporation, is an accounting and auditing firm registered with the Public Company Accounting Oversight Board ("PCAOB"). Boros & Farrington has two partners and two professional staff located in San Diego, California.

C. FACTS

1. Lack of Independence

a. During fiscal years 2010 through 2012 (the "Relevant Period"), Boros & Farrington served as the independent public accountant for 26 broker-dealer audit clients. In connection with at least one audit performed for each of these broker-dealer audit clients during the Relevant Period, Boros & Farrington prepared the financial statements and/or notes to the financial statements that were filed with the Commission on Form X-17A-5.

b. For example, Boros & Farrington audited the annual financial statements for Broker-Dealer A for the fiscal year ending March 31, 2012. During the audit, Boros & Farrington was provided with financial documents generated by Broker-Dealer A, including a trial balance, balance sheet, incomes statement, and FOCUS report. Boros & Farrington reviewed and tested these documents, and the financial data contained therein, as part of the audit.

c. Boros & Farrington then utilized the information contained in these documents to create and revise a set of financial statements to be filed with the Commission. In particular, using the prior year's financial statements as a template, Boros & Farrington personnel working on Boros & Farrington computers typed and updated the new set of financial statements, including the notes to the financial statements. Boros & Farrington then provided the set of financial statements it had prepared to Broker-Dealer A's management for approval.

d. In May 2012, Broker-Dealer A filed with the Commission a Form X-17A-5 Part III for the fiscal year ended March 31, 2012. Included in that filing is an audit report signed by Boros & Farrington and stating, among other things, that Boros & Farrington's audit of Broker-Dealer A was conducted "in accordance with the Public Company Accounting Oversight Board (United States)." Boros & Farrington has acknowledged that this statement was made in error. Despite this statement, Boros & Farrington applied generally accepted auditing standards as established by the American Institute of Certified Public Accountants to the audit of Broker-Dealer A.

e. Boros & Farrington engaged in substantially similar conduct in connection with at least one audit for 25 additional broker-dealer clients during the Relevant Period.

2. **Violations**

a. Section 17(e)(1)(A) of the Exchange Act requires that every registered broker or dealer "annually file with the Commission a balance sheet and income statement certified by an independent public accounting firm, or by a registered public accounting firm if the firm is required to be registered under the Sarbanes-Oxley Act of 2002, prepared on a calendar or fiscal year basis, and such other financial statements (which shall, as the Commission specifies, be certified) and information concerning its financial condition as the Commission, by rule may prescribe as necessary or appropriate in the public interest or for the protection of investors."

b. Exchange Act Rule 17a-5(e)(1)(i) states: "An audit shall be conducted by a public accountant who shall be in fact independent as defined in paragraph (f)(3) of this section herein, and he shall give an opinion covering the statements filed pursuant to paragraph (d) . . . ." Exchange Act Rule 17a-5(f)(3) further states that, for such audits, "[a]n accountant shall be independent in accordance with the provisions of Rule 2-01(b) and (c) of Regulation S-X."

c. Exchange Act Rule 17a-5(g) requires that "[t]he audit shall be made in accordance with generally accepted auditing standards" and Exchange Act Rule 17a-5(i) requires that "[t]he accountant's report shall . . . [s]tate whether the audit was made in accordance with generally accepted auditing standards." Generally accepted auditing standards ("GAAS") require auditors to maintain strict independence from their audit clients; an auditor "must be free from any obligation to or interest in the client, its management or its owners." *See* Statement on Auditing Standard No. 1, Section 220.03. Accordingly, if an auditor's report states that its audit was performed in accordance with GAAS when the auditor was not independent, then it has violated Exchange Act Rule 17a-5(i). *See In the Matter of Rosenberg Rich Baker Berman & Company and Brian Zucker, CPA,* Exchange Act Release No. 69765 at p. 5 (June 14, 2013).

d. Rule 2-01(c)(4) of Regulation S-X provides that accountants are not independent if, at any point during the audit and professional engagement period, the accountant provides prohibited non-audit services to an audit client. Rule 2-01(c)(4)(i) of Regulation S-X provides that prohibited non-audit services include bookkeeping or other services related to the accounting records or financial statements of the audit client, and defines such services as:

> Any service, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including:
>
> (A) Maintaining or preparing the audit client's accounting records;
>
> (B) Preparing the audit client's financial statements that are filed with the Commission or that form the basis of financial statements filed with the Commission; or

(C) Preparing or originating source data underlying the audit client's financial statements.

e. Rule 2-01(c)(4)(i) of Regulation S-X specifically prohibits an audit firm from preparing an audit client's financial statements that are filed with the Commission. In this context, preparing financial statements includes but is not limited to: aggregating line items from internal books and records to the financial statements; changing line item descriptions; drafting or editing notes to the financial statements; and converting FOCUS reports or bookkeeping software program reports into financial statements. With respect to the audit of Broker-Dealer A, and the additional audits in which Boros & Farrington engaged in substantially similar conduct, Boros & Farrington engaged in one or more of the above prohibited actions.

f. As a result of Boros & Farrington's conduct in preparing the financial statements, including the notes thereto, Boros & Farrington was not independent of its broker-dealer audit clients under the independence criteria established by Rule 2-01(c)(4) of Regulation S-X, which Exchange Act Rule 17a-5 made applicable to the audits of broker-dealer financial statements. As the Commission explained in adopting Rule 2-01(c)(4), providing such services for an audit client "impairs the auditor's independence because the auditor will be placed in the position of auditing the firm's work when auditing the client's financial statements. . . . In addition, keeping the books is a management function, the performance of which leads to an inappropriate mutuality of interests between the auditor and the audit client." *Revision of the Commission's Auditor Independence Requirements*, Exchange Act Release No. 43602, at IV.D.4.b(i) (November 21, 2000). *See also Strengthening the Commission's Requirements Regarding Auditor Independence*, Exchange Act Release No. 47265 ("keeping the books is a management function, which also is prohibited")(January 28, 2003).

g. Boros & Farrington failed to identify in its audit reports whether its audits were conducted in accordance with GAAS. Even if Boros & Farrington's audit reports had stated that it performed the audits in accordance with GAAS, which was Boros & Farrington's intent, such a representation would have been false because of the independence impairments described above. Accordingly, Boros & Farrington violated Exchange Act Rule 17a-5(i).

h. Exchange Act Section 17(a) and Rule 17a-5 require broker-dealers to file annual reports containing financial statements audited by independent public accountants. No showing of scienter is necessary to establish a violation of Exchange Act Section 17(a)(1). *See In the Matter of Orlando Joseph Jett*, Exchange Act Release No. 49366 at n.45 (March 5, 2004) (citing *SEC v Drexel Burham Lambert Inc.*, 837 F. Supp. 587, 610 (S.D.N.Y. 1993); *Stead v. SEC*, 444 F.2d 713, 716-17 (10th Cir. 1971), *cert denied*, 404 U.S. 1059 (1972)).

i. Under Section 21C of the Exchange Act, a person is a "cause" of another's primary violation if the person knew or should have known that his act or omission would contribute to the primary violation. Negligence is sufficient to establish "causing" liability under Section 21C when a person is alleged to have caused a primary violation that does not require scienter. *In re KPMG*

Peat Marwick, Exch. Act. Rel. No. 43862 (Jan. 19, 2001), *aff'd, KPMG v. SEC*, 289 F.3d 109 (D.C. Cir. 2002).

j. Boros & Farrington caused its broker-dealer audit clients to violate Exchange Act Section 17(a) and Rule 17a-5. Boros & Farrington, an audit firm registered with the PCAOB and operated by Certified Public Accountants, knew or should have known that its conduct contributed to its audit clients' violations of Exchange Act Section 17(a) and Rule 17a-5.

k. Rule 102(e) of the Commission's Rules of Practice allows the Commission to censure a person if it finds that such person has engaged in "improper professional conduct." Exchange Act § 4C(a)(2); Rule 102(e)(1)(ii). Rule 102(e) defines improper professional conduct, in part, as: "[a] single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the registered public accounting firm or associated person knows, or should know, that heightened scrutiny is warranted." Exchange Act § 4C(b)(2); Rule 102(e)(1)(iv)(B).

l. Questions regarding an auditor's independence always warrant heightened scrutiny. *See* Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57164, 57168 (Oct. 26, 1998) (codified at 17 C.F.R. Part 201). The Commission has defined the "highly unreasonable" standard as:

> an intermediate standard, higher than ordinary negligence but lower than the traditional definition of recklessness used in cases brought under Section 10(b) of the Exchange Act and Rule 10b-5 of the Exchange Act. The highly unreasonable standard is an objective standard. The conduct at issue is measured by the degree of the departure from professional standards and not the intent of the accountant.

Id. at 57,167; *see also In the Matter of Ernst & Young LLP*, Admin. Proc. File No. 3-10933, SEC Initial Decision Release No. 249, at 60 (Apr. 16, 2004).

m. Based on the conduct set forth above, Boros & Farrington engaged in highly unreasonable conduct that resulted in violations of applicable professional standards when it knew or should have known that heightened scrutiny was required.

3. <u>Findings</u>

a. Based on the foregoing, the Commission finds that Boros & Farrington engaged in improper professional conduct pursuant to Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

b. Based on the foregoing, the Commission finds that Boros & Farrington committed violations of Exchange Act Rule 17a-5(i) and caused 26 broker-dealers' violations of Section 17(a) and Rule 17a-5 promulgated thereunder.

4. **Respondent's Remedial Efforts and Cooperation**

In determining to accept the Offer, the Commission considered the remedial acts undertaken by Respondent and the cooperation afforded the Commission staff.

5. **Undertakings**

Boros & Farrington undertakes:

a. within ninety (90) days from the date of the Order, to establish written policies and procedures, or to revise and/or supplement existing written policies and procedures, for the purpose of providing Boros & Farrington with reasonable assurance of compliance with applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement (defined to mean an engagement to provide a report – whether an audit report, an examination report, or a review report – required under Exchange Act Rule 17a-5(d)(1)(i)(C), as amended);

b. within ninety (90) days from the date of the Order, to establish a policy of ensuring training, whether internal or external, on an annual or more frequent regular basis, concerning applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement, of any Firm audit personnel who participate in any way in the planning or performing of any SEC Registered Broker-Dealer Engagement;

c. within ninety (90) days from the date of the Order and before Boros & Farrington's commencement of any SEC Registered Broker-Dealer Engagement (or, where Boros & Farrington by the date of this Order has already commenced but not completed such an engagement, before Boros & Farrington's release of its report), to ensure training pursuant to the policy described in paragraph (5)(b) above has been provided on at least one occasion;

d. to provide a copy of the Order –

(i) within thirty (30) days from the date of the Order, to all audit personnel employed by, or associated with (as defined in PCAOB Rule 1001(p)(i)), Boros & Farrington as of the date of the Order; and

(ii) within thirty (30) days from the date of the Order, to any client of Boros & Farrington as of the date of the Order for which Boros & Farrington has performed or has been engaged to perform an SEC Registered Broker-Dealer Engagement;

e. to certify in writing to Stephen L. Cohen, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5553, Boros & Farrington's compliance with paragraphs 5(a) through 5(d)(ii) above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. Boros & Farrington shall submit such certification within one hundred twenty (120) days from the date of the Order. Boros & Farrington shall also submit such additional evidence of and information concerning compliance as the staff of the Division of Enforcement may reasonably request.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Boros & Farrington's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Boros & Farrington is hereby censured.

B. Boros & Farrington shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-5 promulgated thereunder.

C. Boros & Farrington shall comply with the undertakings enumerated in Section (III)(C)(5) above.

D. Boros & Farrington shall, within seven days of the entry of this Order, pay a civil money penalty in the amount of $30,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Boros & Farrington as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Stephen L. Cohen, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5553.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar
dissent as to penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73774 / December 8, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3609 / December 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16305

In the Matter of OUM & Co. LLP, Respondent.	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against OUM & Co. LLP ("OUM" or "Respondent") pursuant to Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[2]

1 Section 4C provides, in relevant part, that:

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

2 Rule 102(e)(1)(ii) provides, in relevant part, that:

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this the Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[3] that:

A. SUMMARY

This matter concerns violations of the Commission's auditor independence rules by OUM. OUM audited the annual financial statements that were filed with the Commission for six broker-dealer audit clients for the fiscal years 2010, 2011, and/or 2012. For at least one audit of four of these broker-dealer audit clients, OUM was not independent under auditor independence criteria established by the Commission and made applicable by Exchange Act Rule 17a-5(f)(3) to audits of brokers and dealers.[4] As a result of this conduct, OUM engaged in improper professional conduct, violated the auditor independence rules, and caused each of the four broker-dealers' failure to file an annual report audited by an independent accountant.

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

3 The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

4 The provisions of Exchange Act Rule 17a-5 referred to herein are those in effect during, and applicable to, the relevant conduct. On July 30, 2013, the Commission adopted certain amendments to Rule 17a-5. *See* Broker-Dealer Reports, SEC Exchange Act Release No. 34-70073 (July 30, 2013), 78 Fed. Reg. 51910 (Aug. 21, 2013). Among other things, the amendments to Rule 17a-5 require that audits of brokers and dealers be performed in accordance with Public Company Accounting Oversight Board standards, effective for audits of fiscal years ending on or after June 1, 2014. The auditor independence requirement of Rule 2-01 of Regulation S-X applied to broker-dealer audits both before and after the July 30, 2013 amendments. At the time of the relevant conduct, prior to the amendments, that requirement was set out in Rule 17a-5(f)(3). It is now set out in Rule 17a-5(f)(1).

B. RESPONDENT

Respondent OUM, a limited liability partnership, is an accounting and auditing firm registered with the Public Company Accounting Oversight Board ("PCAOB"). OUM has 11 partners and 54 professional staff located in three offices located in California.

C. FACTS

1. Lack of Independence

a. During fiscal years 2010 through 2012 (the "Relevant Period"), OUM served as the independent public accountant for six broker-dealer audit clients. In connection with at least one audit performed for four of its broker-dealer audit clients during the Relevant Period, OUM prepared the financial statements and/or notes to the financial statements that were filed with the Commission on Form X-17A-5.

b. For example, OUM audited the annual financial statements for Broker-Dealer A for the fiscal year ending December 31, 2011. During the audit, OUM was provided with financial documents generated by Broker-Dealer A, including a trial balance and other financial data. OUM reviewed and tested these documents, and the financial data contained therein, as part of the audit.

c. OUM then utilized the information contained in these documents to create and revise a set of financial statements to be filed with the Commission. In particular, using the prior year's financial statements as a template, OUM personnel working on OUM computers typed and updated the new set of financial statements, including the notes to the financial statements. OUM then provided the set of financial statements it had prepared to Broker-Dealer A's management for approval.

d. In February 2012, Broker-Dealer A filed with the Commission a Form X-17A-5 Part III for the fiscal year ended December 31, 2011. Included in that filing is an audit report signed by OUM and stating, among other things, that OUM's audit of Broker-Dealer A was conducted "in accordance with auditing standards generally accepted in the United States of America."

e. OUM engaged in substantially similar conduct in connection with at least one audit for three additional broker-dealer clients during the Relevant Period.

2. Violations

a. Section 17(e)(1)(A) of the Exchange Act requires that every registered broker or dealer "annually file with the Commission a balance sheet and income statement certified by an independent public accounting firm, or by a registered public accounting firm if the firm is required to be registered under the Sarbanes-Oxley Act of 2002, prepared on a calendar or fiscal year basis, and such other financial statements (which shall, as the Commission specifies, be certified) and information concerning its financial condition as the Commission, by rule may prescribe as necessary or appropriate in the public interest or for the protection of investors."

b. Exchange Act Rule 17a-5(e)(1)(i) states: "An audit shall be conducted by a public accountant who shall be in fact independent as defined in paragraph (f)(3) of this section herein, and he shall give an opinion covering the statements filed pursuant to paragraph (d) . . . ." Exchange Act Rule 17a-5(f)(3) further states that, for such audits, "[a]n accountant shall be independent in accordance with the provisions of Rule 2-01(b) and (c) of Regulation S-X."

c. Exchange Act Rule 17a-5(g) requires that "[t]he audit shall be made in accordance with generally accepted auditing standards" and Exchange Act Rule 17a-5(i) requires that "[t]he accountant's report shall . . . [s]tate whether the audit was made in accordance with generally accepted auditing standards." Generally accepted auditing standards ("GAAS") require auditors to maintain strict independence from their audit clients; an auditor "must be free from any obligation to or interest in the client, its management or its owners." *See* Statement on Auditing Standard No. 1, Section 220.03. Accordingly, if an auditor's report states that its audit was performed in accordance with GAAS when the auditor was not independent, then it has violated Exchange Act Rule 17a-5(i). *See In the Matter of Rosenberg Rich Baker Berman & Company and Brian Zucker, CPA,* Exchange Act Release No. 69765 at p. 5 (June 14, 2013).

d. Rule 2-01(c)(4) of Regulation S-X provides that accountants are not independent if, at any point during the audit and professional engagement period, the accountant provides prohibited non-audit services to an audit client. Rule 2-01(c)(4)(i) of Regulation S-X provides that prohibited non-audit services include bookkeeping or other services related to the accounting records or financial statements of the audit client, and defines such services as:

> Any service, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including:
>
> (A) Maintaining or preparing the audit client's accounting records;
>
> (B) Preparing the audit client's financial statements that are filed with the Commission or that form the basis of financial statements filed with the Commission; or
>
> (C) Preparing or originating source data underlying the audit client's financial statements.

e. Rule 2-01(c)(4)(i) of Regulation S-X specifically prohibits an audit firm from preparing an audit client's financial statements that are filed with the Commission. In this context, preparing financial statements includes but is not limited to: aggregating line items from internal books and records to the financial statements; changing line item descriptions; drafting or editing notes to the financial statements; and converting FOCUS reports or bookkeeping software program reports into financial statements. With respect to the audit of Broker-Dealer A, and the additional audits in which OUM engaged in substantially similar conduct, OUM engaged in one or more of the above prohibited actions.

f. As a result of OUM's conduct in preparing the financial statements, including the notes thereto, OUM was not independent of its broker-dealer audit clients under the independence criteria established by Rule 2-01(c)(4) of Regulation S-X, which Exchange Act Rule 17a-5 made applicable to the audits of broker-dealer financial statements. As the Commission explained in adopting Rule 2-01(c)(4), providing such services for an audit client "impairs the auditor's independence because the auditor will be placed in the position of auditing the firm's work when auditing the client's financial statements. . . . In addition, keeping the books is a management function, the performance of which leads to an inappropriate mutuality of interests between the auditor and the audit client." *Revision of the Commission's Auditor Independence Requirements*, Exchange Act Release No. 43602, at IV.D.4.b(i) (November 21, 2000). *See also Strengthening the Commission's Requirements Regarding Auditor Independence*, Exchange Act Release No. 47265 ("keeping the books is a management function, which also is prohibited")(January 28, 2003).

g. OUM violated Exchange Act Rule 17a-5(i) by representing in its audit reports that it had performed the audits of the broker-dealers' financial statements in accordance with GAAS when in fact, because of the independence impairment described above, the audits had not been performed in accordance with GAAS.

h. Exchange Act Section 17(a) and Rule 17a-5 require broker-dealers to file annual reports containing financial statements audited by independent public accountants. No showing of scienter is necessary to establish a violation of Exchange Act Section 17(a)(1). *See In the Matter of Orlando Joseph Jett*, Exchange Act Release No. 49366 at n.45 (March 5, 2004) (citing *SEC v Drexel Burham Lambert Inc.*, 837 F. Supp. 587, 610 (S.D.N.Y. 1993); *Stead v. SEC*, 444 F.2d 713, 716-17 (10th Cir. 1971), *cert denied*, 404 U.S. 1059 (1972)).

i. Under Section 21C of the Exchange Act, a person is a "cause" of another's primary violation if the person knew or should have known that his act or omission would contribute to the primary violation. Negligence is sufficient to establish "causing" liability under Section 21C when a person is alleged to have caused a primary violation that does not require scienter. *In re KPMG Peat Marwick*, Exch. Act. Rel. No. 43862 (Jan. 19, 2001), *aff'd, KPMG v. SEC*, 289 F.3d 109 (D.C. Cir. 2002).

j. OUM caused its broker-dealer audit clients to violate Exchange Act Section 17(a) and Rule 17a-5. OUM, an audit firm registered with the PCAOB and operated by Certified Public Accountants, knew or should have known that its conduct, including incorrectly stating in audit reports that the audits were conducted in accordance with GAAS, contributed to its audit clients' violations of Exchange Act Section 17(a) and Rule 17a-5.

k. Rule 102(e) of the Commission's Rules of Practice allows the Commission to censure a person if it finds that such person has engaged in "improper professional conduct."

Exchange Act § 4C(a)(2); Rule 102(e)(1)(ii). Rule 102(e) defines improper professional conduct, in part, as: "[a] single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the registered public accounting firm or associated person knows, or should know, that heightened scrutiny is warranted." Exchange Act § 4C(b)(2); Rule 102(e)(1)(iv)(B).

l. Questions regarding an auditor's independence always warrant heightened scrutiny. *See* Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57,164, 57,168 (Oct. 26, 1998) (codified at 17 C.F.R. Part 201). The Commission has defined the "highly unreasonable" standard as:

> an intermediate standard, higher than ordinary negligence but lower than the traditional definition of recklessness used in cases brought under Section 10(b) of the Exchange Act and Rule 10b-5 of the Exchange Act. The highly unreasonable standard is an objective standard. The conduct at issue is measured by the degree of the departure from professional standards and not the intent of the accountant.

Id. at 57,167; *see also In the Matter of Ernst & Young LLP*, Admin. Proc. File No. 3-10933, SEC Initial Decision Release No. 249, at 60 (Apr. 16, 2004).

m. Based on the conduct set forth above, OUM engaged in highly unreasonable conduct that resulted in violations of applicable professional standards when it knew or should have known that heightened scrutiny was required.

3. <u>Findings</u>

a. Based on the foregoing, the Commission finds that OUM engaged in improper professional conduct pursuant to Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

b. Based on the foregoing, the Commission finds that OUM committed violations of Exchange Act Rule 17a-5(i) and caused four broker-dealers' violations of Section 17(a) and Rule 17a-5 promulgated thereunder.

4. <u>Respondent's Remedial Efforts and Cooperation</u>

In determining to accept the Offer, the Commission considered the remedial acts undertaken by Respondent and the cooperation afforded the Commission staff.

5. <u>Undertakings</u>

OUM undertakes:

a. within ninety (90) days from the date of the Order, to establish written policies and procedures, or to revise and/or supplement existing written policies and procedures, for the purpose of providing OUM with reasonable assurance of compliance with applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement (defined to mean an engagement to provide a report – whether an audit report, an examination report, or a review report – required under Exchange Act Rule 17a-5(d)(1)(i)(C), as amended);

b. within ninety (90) days from the date of the Order, to establish a policy of ensuring training, whether internal or external, on an annual or more frequent regular basis, concerning applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement, of any Firm audit personnel who participate in any way in the planning or performing of any SEC Registered Broker-Dealer Engagement;

c. within ninety (90) days from the date of the Order and before OUM's commencement of any SEC Registered Broker-Dealer Engagement (or, where OUM by the date of this Order has already commenced but not completed such an engagement, before OUM's release of its report), to ensure training pursuant to the policy described in paragraph (5)(b) above has been provided on at least one occasion;

d. to provide a copy of the Order –

(i) within thirty (30) days from the date of the Order, to all audit personnel employed by, or associated with (as defined in PCAOB Rule 1001(p)(i)), OUM as of the date of the Order; and

(ii) within thirty (30) days from the date of the Order, to any client of OUM as of the date of the Order for which OUM has performed or has been engaged to perform an SEC Registered Broker-Dealer Engagement;

e. within ninety (90) days from the date of the Order, to designate and maintain at least one partner (the "Independence Partner") in its national office or headquarters with responsibility for monitoring OUM's compliance with the SEC's auditor independence rules, including without limitation, the adoption, implementation and oversight of policies and procedures designed to provide OUM with reasonable assurance of such compliance;

f. within ninety (90) days from the date of the Order, to adopt and implement written procedures to provide reasonable assurance that prohibited bookkeeping services will not be provided in connection with any SEC Registered Broker-Dealer Engagement, including procedures requiring OUM to complete, on an annual basis, a client continuance form for each SEC Registered Broker-Dealer Engagement, which shall contain an assessment of risks and a listing of non-audit services being provided, and procedures requiring OUM's Independence Partner to monitor the annual completion and review of client continuance forms for all SEC Registered Broker-Dealer Engagements as well as the annual review of such other documents, forms or other information sufficient to determine whether any prohibited bookkeeping services are being provided in connection with any SEC Registered Broker-Dealer Engagements; and

g. to certify in writing to Stephen L. Cohen, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5553, OUM's compliance with paragraphs 5(a) through 5(f) above. The certification, which shall be signed by the Independence Partner, shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. OUM shall submit such certification within one hundred twenty (120) days from the date of the Order. OUM shall also submit such additional evidence of and information concerning compliance as the staff of the Division of Enforcement may reasonably request.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent OUM's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. OUM is hereby censured.

B. OUM shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-5 promulgated thereunder.

C. OUM shall comply with the undertakings enumerated in Section (III)(C)(5) above.

D. OUM shall, within seven days of the entry of this Order, pay a civil money penalty in the amount of $10,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying OUM as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Stephen L. Cohen, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5553.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar dissent as to penalty

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73775 / December 8, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3610 / December 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16306

In the Matter of **Lerner & Sipkin CPAs LLP,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Lerner & Sipkin CPAs LLP ("Respondent" or "Lerner") pursuant to Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[2]

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1 Section 4C provides, in relevant part, that:

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

2 Rule 102(e)(1)(ii) provides, in pertinent part, that:

> The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[3] that:

A. SUMMARY

This matter concerns violations of the Commission's auditor independence rules by Lerner. Lerner audited the annual financial statements that were filed with the Commission for 74 broker-dealer audit clients for the fiscal years 2010, 2011, and/or 2012. For at least one audit of approximately 70 of these broker-dealer audit clients, Lerner was not independent under auditor independence criteria established by the Commission and made applicable by Exchange Act Rule 17a-5(f)(3) to audits of brokers and dealers.[4] As a result of this conduct, Lerner engaged in improper professional conduct, violated the auditor independence rules, and caused each of the approximately 70 broker-dealers' failure to file an annual report audited by an independent accountant.

B. RESPONDENT

Respondent Lerner, a limited liability partnership, is an accounting and auditing firm registered with the Public Company Accounting Oversight Board ("PCAOB"). Lerner has two partners and three additional professional staff located in one office in the state of New York.

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3 The findings are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

4 The provisions of Exchange Act Rule 17a-5 referred to herein are those in effect during, and applicable to, the relevant conduct. On July 30, 2013, the Commission adopted certain amendments to Rule 17a-5. *See* Broker-Dealer Reports, SEC Exchange Act Release No. 34-70073 (July 30, 2013), 78 Fed. Reg. 51910 (Aug. 21, 2013). Among other things, the amendments to Rule 17a-5 require that audits of brokers and dealers be performed in accordance with Public Company Accounting Oversight Board standards, effective for audits of fiscal years ending on or after June 1, 2014. The auditor independence requirement of Rule 2-01 of Regulation S-X applied to broker-dealer audits both before and after the July 30, 2013 amendments. At the time of the relevant conduct, prior to the amendments, that requirement was set out in Rule 17a-5(f)(3). It is now set out in Rule 17a-5(f)(1).

C. FACTS

1. Lack of Independence

a. During fiscal years 2010 through 2012 (the "Relevant Period"), Lerner served as the independent public accountant for 74 broker-dealer audit clients. In connection with at least one audit performed for approximately 70 of its broker-dealer audit clients during the Relevant Period, Lerner prepared the financial statements and/or notes to the financial statements that were filed with the Commission on Form X-17A-5.

b. For example, Lerner audited the annual financial statements for one of its broker-dealer clients ("Broker-Dealer A") for the fiscal year ending 2011. During the audit, Lerner was provided with financial documents generated by Broker-Dealer A, including its financial statements for the prior year and its most recent four FOCUS reports.

c. Lerner then utilized the information contained in these documents to create a set of financial statements to be filed with the Commission. In particular, using the prior year's financial statements as a template and filling in this year's information from Broker-Dealer A's four most recent FOCUS reports and other information gathered from Broker-Dealer A, Lerner personnel working on Lerner computers typed and updated the new set of financial statements, including the notes to the financial statements and the cash flow statement. Lerner then provided the set of financial statements it had prepared to Broker-Dealer A's management for approval.

d. In February 2012, Broker-Dealer A filed with the Commission a Form X-17A-5 Part III for the fiscal year ended December 31, 2011. Included in that filing is an audit report signed by Lerner and stating, among other things, that Lerner's audit of Broker-Dealer A was conducted "in accordance with auditing standards generally accepted in the United States of America."

e. Lerner engaged in substantially similar conduct in connection with at least one audit for approximately 69 additional broker-dealer clients during the Relevant Period.

2. Violations

a. Section 17(e)(1)(A) of the Exchange Act requires that every registered broker or dealer "annually file with the Commission a balance sheet and income statement certified by an independent public accounting firm, or by a registered public accounting firm if the firm is required to be registered under the Sarbanes-Oxley Act of 2002, prepared on a calendar or fiscal year basis, and such other financial statements (which shall, as the Commission specifies, be certified) and information concerning its financial condition as the Commission, by rule may prescribe as necessary or appropriate in the public interest or for the protection of investors."

b. Exchange Act Rule 17a-5(e)(1)(i) states: "An audit shall be conducted by a public accountant who shall be in fact independent as defined in paragraph (f)(3) of this section herein, and he shall give an opinion covering the statements filed pursuant to paragraph (d) . . . ." Exchange Act Rule 17a-5(f)(3) further states that, for such audits, "[a]n accountant shall be independent in accordance with the provisions of Rule 2-01(b) and (c) of Regulation S-X."

c. Exchange Act Rule 17a-5(g) requires that "[t]he audit shall be made in accordance with generally accepted auditing standards" and Exchange Act Rule 17a-5(i) requires that "[t]he accountant's report shall . . . [s]tate whether the audit was made in accordance with generally accepted auditing standards." Generally accepted auditing standards ("GAAS") require auditors to maintain strict independence from their audit clients; an auditor "must be free from any obligation to or interest in the client, its management or its owners." *See* Statement on Auditing Standard No. 1, Section 220.03. Accordingly, if an auditor's report states that its audit was performed in accordance with GAAS when the auditor was not independent, then it has violated Exchange Act Rule 17a-5(i). *See In the Matter of Rosenberg Rich Baker Berman & Company and Brian Zucker, CPA,* Exchange Act Release No. 69765 at p. 5 (June 14, 2013).

d. Rule 2-01(c)(4) of Regulation S-X provides that accountants are not independent if, at any point during the audit and professional engagement period, the accountant provides prohibited non-audit services to an audit client. Rule 2-01(c)(4)(i) of Regulation S-X provides that prohibited non-audit services include bookkeeping or other services related to the accounting records or financial statements of the audit client, and defines such services as:

> Any service, unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements, including:
>
> (A) Maintaining or preparing the audit client's accounting records;
>
> (B) Preparing the audit client's financial statements that are filed with the Commission or that form the basis of financial statements filed with the Commission; or
>
> (C) Preparing or originating source data underlying the audit client's financial statements.

e. Rule 2-01(c)(4)(i) of Regulation S-X specifically prohibits an audit firm from preparing an audit client's financial statements that are filed with the Commission. In this context, preparing financial statements includes but is not limited to: aggregating line items from internal books and records to the financial statements; changing line item descriptions; drafting or editing notes to the financial statements; and converting FOCUS reports or bookkeeping software program reports into financial statements. With respect to the audit of Broker-Dealer A, and the additional audits in which Lerner engaged in substantially similar conduct, Lerner engaged in one or more of the above prohibited actions.

f. As a result of Lerner's conduct in preparing the financial statements, including the notes thereto, Lerner was not independent of its broker-dealer audit clients under the independence criteria established by Rule 2-01(c)(4) of Regulation S-X, which Exchange Act Rule 17a-5 made applicable to the audits of broker-dealer financial statements. As the Commission explained in adopting Rule 2-01(c)(4), providing such services for an audit client "impairs the auditor's independence because the auditor will be placed in the position of auditing the firm's work when auditing the client's financial statements. . . . In addition, keeping the books is a management function, the performance of which leads to an inappropriate mutuality of interests between the auditor and the audit client." *Revision of the Commission's Auditor Independence Requirements*, Exchange Act Release No. 43602, at IV.D.4.b(i) (November 21, 2000). *See also Strengthening the Commission's Requirements Regarding Auditor Independence*, Exchange Act Release No. 47265 ("keeping the books is a management function, which also is prohibited")(January 28, 2003).

g. Lerner violated Exchange Act Rule 17a-5(i) by representing in its audit reports that it had performed the audits of the broker-dealers' financial statements in accordance with GAAS when in fact, because of the independence impairment described above, the audits had not been performed in accordance with GAAS.

h. Exchange Act Section 17(a) and Rule 17a-5 require broker-dealers to file annual reports containing financial statements audited by independent public accountants. No showing of scienter is necessary to establish a violation of Exchange Act Section 17(a)(1). *See In the Matter of Orlando Joseph Jett*, Exchange Act Release No. 49366 at n.45 (March 5, 2004) (citing *SEC v Drexel Burham Lambert Inc.*, 837 F. Supp. 587, 610 (S.D.N.Y. 1993); *Stead v. SEC*, 444 F.2d 713, 716-17 (10th Cir. 1971), *cert denied*, 404 U.S. 1059 (1972)).

i. Under Section 21C of the Exchange Act, a person is a "cause" of another's primary violation if the person knew or should have known that his act or omission would contribute to the primary violation. Negligence is sufficient to establish "causing" liability under Section 21C when a person is alleged to have caused a primary violation that does not require scienter. *In re KPMG Peat Marwick*, Exch. Act. Rel. No. 43862 (Jan. 19, 2001), *aff'd, KPMG v. SEC*, 289 F.3d 109 (D.C. Cir. 2002).

j. Lerner caused its broker-dealer audit clients to violate Exchange Act Section 17(a) and Rule 17a-5. Lerner, an audit firm registered with the PCAOB and operated by a Certified Public Accountant, knew or should have known that its conduct, including incorrectly stating in audit reports that the audits were conducted in accordance with GAAS, contributed to its audit clients' violations of Exchange Act Section 17(a) and Rule 17a-5.

k. Rule 102(e) of the Commission's Rules of Practice allows the Commission to censure a person if it finds that such person has engaged in "improper professional conduct." Exchange Act § 4C(a)(2); Rule 102(e)(1)(ii). Rule 102(e) defines improper professional conduct, in part, as: "[a] single instance of highly unreasonable conduct that results in a violation of applicable professional standards in circumstances in which the registered public accounting firm or associated person knows, or should know, that heightened scrutiny is warranted." Exchange Act § 4C(b)(2); Rule 102(e)(1)(iv)(B).

l. Questions regarding an auditor's independence always warrant heightened scrutiny. *See* Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57,164, 57,168 (Oct. 26, 1998) (codified at 17 C.F.R. Part 201). The Commission has defined the "highly unreasonable" standard as:

> an intermediate standard, higher than ordinary negligence but lower than the traditional definition of recklessness used in cases brought under Section 10(b) of the Exchange Act and Rule 10b-5 of the Exchange Act. The highly unreasonable

standard is an objective standard. The conduct at issue is measured by the degree of the departure from professional standards and not the intent of the accountant.

Id. at 57,167; *see also In the Matter of Ernst & Young LLP*, Admin. Proc. File No. 3-10933, SEC Initial Decision Release No. 249, at 60 (Apr. 16, 2004).

m. Based on the conduct set forth above, Lerner engaged in highly unreasonable conduct that resulted in violations of applicable professional standards when it knew or should have known that heightened scrutiny was required.

3. **Findings**

a. Based on the foregoing, the Commission finds that Lerner engaged in improper professional conduct pursuant to Exchange Act Section 4C(a)(2) and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.

b. Based on the foregoing, the Commission finds that Lerner committed violations of Exchange Act Rule 17a-5(i) and caused approximately 70 broker-dealers' violations of Section 17(a) and Rule 17a-5 promulgated thereunder.

4. **Respondent's Remedial Efforts and Cooperation**

In determining to accept the Offer, the Commission considered the remedial acts undertaken by Respondent and the cooperation afforded the Commission staff in its investigation. As part of its remediation, Lerner has already implemented or begun to implement some of the Undertakings listed below.

5. **Undertakings**

Lerner undertakes:

a. within ninety (90) days from the date of the Order, to establish written policies and procedures, or to revise and/or supplement existing written policies and procedures, for the purpose of providing Lerner with reasonable assurance of compliance with applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement (defined to mean an engagement to provide a report – whether an audit report, an examination report, or a review report – required under Exchange Act Rule 17a-5(d)(1)(i)(C), as amended);

b. within ninety (90) days from the date of the Order, to establish a policy of ensuring training, whether internal or external, on an annual or more frequent regular basis, concerning applicable independence requirements, including those requirements of Rule 2-01 of Regulation S-X applicable to an SEC Registered Broker-Dealer Engagement, of any Firm audit personnel who participate in any way in the planning or performing of any SEC Registered Broker-Dealer Engagement;

c. within ninety (90) days from the date of the Order and before Lerner's commencement of any SEC Registered Broker-Dealer Engagement (or, where Lerner by the date of this Order has already commenced but not completed such an engagement, before Lerner's release of its report), to ensure training pursuant to the policy described in paragraph (5)(b) above has been provided on at least one occasion;

d. to provide a copy of the Order –

(i) within thirty (30) days from the date of the Order, to all audit personnel employed by, or associated with (as defined in PCAOB Rule 1001(p)(i)), Lerner as of the date of the Order; and

(ii) within thirty (30) days from the date of the Order, to any client of Lerner as of the date of the Order for which Lerner has performed or has been engaged to perform an SEC Registered Broker-Dealer Engagement; and

e. to certify in writing to Stephen L. Cohen, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F Street, N.E., Washington, DC 20549-5553, Lerner's compliance with paragraphs 5(a) through 5(d)(ii) above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. Lerner shall submit such certification within one hundred twenty (120) days from the date of the Order. Lerner shall also submit such additional evidence of and information concerning compliance as the staff of the Division of Enforcement may reasonably request.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Lerner's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Lerner is hereby censured.

B. Lerner shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Exchange Act and Rule 17a-5 promulgated thereunder.

C. Lerner shall comply with the undertakings enumerated in Section (III)(C)(5) above.

D. Respondent shall pay civil penalties of $55,000 to the Securities and Exchange Commission. Payment shall be made in the following installments: $25,000 to be paid within seven days of entry of the Order; $10,000 to be paid within 120 days of entry of the Order; $10,000 to be paid within 240 days of entry of the Order; and $10,000 to be paid within 360 days of entry of the Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance of civil penalties, plus any additional interest pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Lerner as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Stephen L. Cohen, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5553.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9685 / December 8, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73783 / December 8, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31366 / December 8, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16307

In the Matter of

BTC TRADING, CORP. AND ETHAN BURNSIDE,

Respondents.

ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b), and 21C of the Securities and Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act"), against BTC Trading, Corp. ("BTC Trading") and Ethan Burnside ("Burnside") (collectively "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondents consent to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings

Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Exchange Act of 1934, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offer, the Commission finds that:

Summary

This matter involves two enterprises -- LTC-Global Virtual Stock Exchange ("LTC-Global") and BTC Virtual Stock Exchange ("BTCT Co.") -- that Burnside and BTC Trading operated as unregistered, online, virtual currency-denominated securities exchanges and broker-dealers during the period from August 2012 through October 2013.[1] Each enterprise launched and operated its own website (www.litecoinglobal.com and www.btct.co) and required interested persons to complete an online registration to open an account and access services. Registered accountholders ("users") could buy, sell and trade securities of businesses listed on the websites using the virtual currencies Bitcoin and Litecoin, and the businesses were themselves primarily virtual currency-related enterprises. Burnside, an experienced computer programmer, and his company, BTC Trading, launched the two website enterprises during the early stages of the adoption and use of these virtual currencies. Through the websites, Burnside also offered shares in unregistered transactions in exchange for bitcoins and litecoins in LTC-Global and LTC-Mining, another virtual currency enterprise founded by Burnside.

Respondents

1. <u>Burnside</u>, age 37, resides in El Segundo, California. Burnside has a background in computer science and has extensive experience as a computer programmer and computer systems engineer. Currently, he is employed as a systems engineer and manager in Los Angeles, California, by a multiplayer online social gaming company. Burnside has never been registered with the Commission in any capacity.

2. <u>BTC Trading, Corp.</u> is a Belize corporation and the alter ego of Burnside that he founded in November 2012. BTC Trading's sole business was the operation of LTC-Global and BTCT Co. BTC Trading is 100% owned and operated by Burnside and has never been registered with the Commission in any capacity.

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[1] For purposes of this Order, a "virtual currency" is a digital representation of value that can be digitally traded and functions as a medium of exchange; a unit of account; and/or a store of value, but does not have legal tender status (i.e., when tendered to a creditor, is a valid and legal offer of payment) in any jurisdiction. It is not issued or guaranteed by any jurisdiction, and fulfills the above functions only by agreement within the community of users of the virtual currency. Virtual currency is distinct from fiat currency, which is the coin and paper money of a country that is designated as its legal tender; circulates; and is customarily used and accepted as a medium of exchange in the issuing country. It also is distinct from e-money, which is a digital representation of fiat currency used to electronically transfer value denominated in fiat currency, i.e., e-money electronically transfers value that has legal tender status.

Other Entities

3. LTC-Global Virtual Stock Exchange was founded and developed by Burnside and BTC Trading as an online, litecoin-denominated "securities exchange." Burnside launched LTC-Global's website (www.litecoinglobal.com) in August 2012, and offered and sold shares of LTC-Global as one of the listings on its website. LTC-Global is not an incorporated entity and has never been registered with the Commission in any capacity. In October 2013, LTC-Global ceased operating.

4. BTC Virtual Stock Exchange was founded and developed by Burnside and BTC Trading as an online, bitcoin-denominated "securities exchange." In December 2012, Burnside launched BTCT Co's website (www.btct.co). BCTC Co. is not an incorporated entity and has never been registered with the Commission in any capacity. In October 2013, BTCT Co. ceased operating.

5. LTC-Mining is a litecoin mining business owned and operated by Burnside.[2] In July and September 2012, Burnside offered and sold litecoin- and bitcoin-denominated "LTC Mining bonds," which entitled "bondholders" to share in any profits LTC Mining earned from mining litecoins. LTC Mining is not an incorporated entity and has never been registered with the Commission in any capacity. In late 2013, LTC-Mining ceased operating.

Respondents Operated as Unregistered Exchanges and Unregistered Broker-Dealers

6. In August 2012, Burnside and BTC Trading launched LTC-Global (www.litecoinglobal.com) as an online, litecoin-denominated securities exchange. Through the website, in exchange for litecoins, registered users bought, sold, and traded securities in initial and secondary securities offerings of businesses (or "issuers') listed on the website.

7. In December 2012, Burnside and BTC Trading launched BTCT Co.'s website (www.btct.co) as an online, bitcoin-denominated securities exchange. BTCT Co. operated almost identically to LTC-Global, but accepted bitcoins, instead of litecoins, as payment.

8. According to its website, BTCT Co. allowed users to "experiment with virtual currency investing by purchasing stock in virtual currency" and/or "start a virtual currency company and issue stock to raise funds" for that company. Although anyone was permitted to register with either website, the websites were marketed to and popular with virtual currency enthusiasts. Issuers listed on the websites primarily were virtual currency-related businesses, such as virtual currency mining operations.

[2] A virtual currency "miner" is an individual or entity that participates in a decentralized virtual currency network by running special software to solve complex algorithms in a distributed proof-of-work or other distributed proof system used to validate transactions in the virtual currency system. Certain virtual currencies (e.g., Bitcoin and Litecoin), self-generate units of the currency by rewarding miners with newly created coins.

9. Burnside launched the two websites when the exchange rates to U.S. dollars ("USD") of Litecoin and Bitcoin were low. From August 2012 to the present, the exchange rate to USD of Litecoin has fluctuated between a low of $0.02 per litecoin on August 27, 2012 and a high of $40.73 per litecoin on November 28, 2013. From December 2012 to the present, the exchange rate to USD of Bitcoin has fluctuated between a low of $12.56 per bitcoin on December 2, 2012 and a high of $1,209.94 per bitcoin on November 30, 2013.

Account Opening, Deposits, and Custody of Customer Funds

10. Any individual or group was permitted to open an account and access the websites' services after completing an online registration form. The only information required for registration was a valid email address, which allowed users of each website to maintain a certain level of anonymity. Registration was free. Once registered, users could view their account history and balance online.

11. Both websites maintained custody of users' litecoins and bitcoins. Registered users deposited litecoins and bitcoins with each site by accessing certain computer software that allowed them to digitally transfer funds. Each website maintained custody of its users' funds, which were co-mingled in the website's virtual currency wallet.[3] Users could request to withdraw their funds at any time. Neither website, however, offered users the ability to convert virtual currency into USD or any other fiat currency.

12. Through posts on an internet website dedicated to Bitcoin known as the Bitcoin Forum (bitcointalk.org) and other websites dedicated to virtual currency, Burnside solicited users to open accounts and access the websites' services. During the relevant operating periods, approximately 2,655 users opened online accounts with LTC-Global and approximately 7,959 users opened online accounts with BTCT Co.

Listing of Initial and Secondary Securities Offerings and Issuance of Shares

13. In order to list the offer and sale of securities on either website, an issuer submitted an online application that included an "investment contract" prepared by the issuer. An investment contact typically included a description of the issuer's operation and the investment being offered. LTC-Global and BTCT Co. charged each issuer a flat listing fee of 250 litecoins and 5 bitcoins respectively. There was also a "terms of service" for the websites that, among other provisions, required that the issuer's business or operation was "legal in the United States."

14. LTC-Global shareholders had to approve a new listing application through an online voting process operated by Burnside. Once a listing application was approved, registered users of either website could create issuances of stock and list initial and secondary offerings of securities. The shares of stock were uncertified; the issuance and subsequent ownership of shares by shareholders was reflected in the online account statements that the website maintained

[3] A virtual currency wallet is a means (software application or other mechanism/medium) for holding, storing and transferring virtual currency.

for all registered users. The website provided each issuer with a list of its shareholders and their holdings every 12 hours so that the issuer could continue to operate its listing if either website ever shut down.

15. Issuers could also advertise their listing by posting a prospectus and business plan online. Issuers could directly post notifications on the websites and, if they did so, all shareholders in that particular issuer automatically received a copy of the notification by email. Although issuers were responsible for posting and updating their content online, Burnside maintained limited moderator-type rights over the websites.

16. Burnside regularly posted information on the Bitcoin Forum and other websites dedicated to virtual currency advertising LTC-Global and BTCT Co.'s listing services. Through these posts, Burnside solicited issuers to utilize the websites' listing services. As a result, during the relevant operating periods, approximately 52 issuers entered into contracts to list their shares with LTC-Global and paid a total of 11,450 litecoins in listing fees and approximately 69 issuers entered into contracts to list their shares with BTCT Co. and paid a total of 210 bitcoins in listing fees. None of the issuers registered a class of securities with the Commission under the Exchange Act, and none of the issuers registered an offering of securities with the Commission under the Securities Act.

Trading, Trade Execution, and Trade Reporting

17. In addition to providing a platform to invest in securities offerings, registered users could initiate and place different types of trades, including options trades, through each website. In exchange for these services, Burnside and BTC Trading received transaction-based compensation based directly on the size or type of securities transaction.

18. In order to initiate and place a trade, registered users entered "bids" and "asks" through an online order book maintained on each website, and each website used a non-discretionary system to match and execute trades according to price and time priority. Neither website received any external orders for securities or routed orders to any other online virtual currency exchange. Both websites reported and publicly displayed all trades, quotes and dividends paid. The websites also reported trading volume for each listed security.

19. Through posts on the Bitcoin Forum and other websites dedicated to virtual currency, Burnside and BTC Trading solicited users to place trades in listed securities in exchange for transaction-based compensation. As a result, during the relevant operating periods, LTC-Global users executed approximately 60,496 trades through LTC-Global's website, paying a total of 12,081 litecoins in transaction-based compensation and BTCT Co. users executed approximately 366,490 trades through BTCT Co.'s website, paying a total of 2,141 bitcoins in transaction-based compensation.

Burnside Winds Down LTC-Global and BTCT Co.

20. Beginning in September 2013, shortly after the Commission staff contacted Burnside, he began an orderly wind down of the operations of both websites. This included disabling the registration and trading functions of the websites while maintaining the users'

ability to request the withdrawal of their funds. Burnside provided the websites' users with advance notice of the wind down and established procedures intended to prevent user losses. During the wind down period, users withdrew funds totaling approximately 200,000 litecoins and 20,000 bitcoins, which were held in virtual currency wallets maintained by each website. By October 31, 2013, both websites had ceased operating.

The Offering of Shares in Unregistered Transactions

21. In separate unregistered transactions, Burnside offered to sell and buy shares of two virtual currency enterprises that he owned and operated.

Offer and Sale of LTC-Global Securities

22. From August 2012 through August 2013, Burnside offered and sold 1,322 dividend-paying shares of LTC-Global, with a maximum of 951 shares outstanding at any given time. The price of the shares ranged between 25 and 399 litecoins per share, and four shares sold for 2 bitcoins per share. The shares were offered on LTC-Global's website as one of its stock listings.

23. Burnside made general solicitations to sell shares of LTC-Global over the Internet, which included posts on the Bitcoin Forum and other Bitcoin-related websites.

24. Burnside raised 109,387 litecoins and 8 bitcoins from the sale of LTC-Global shares. At the time Burnside sold the shares, the total USD value of the litecoins and bitcoins he raised was approximately $92,954.

25. Pursuant to the investment contract with LTC-Global shareholders, Burnside distributed to LTC-Global shareholders 100% of the profits earned from the operation of both websites as dividends. Burnside, who owned approximately 90.5% of the shares of LTC-Global, received dividends totaling 67,751 litecoins. The total USD value of the dividends received by Burnside at the time the dividends were paid was approximately $102,653.

26. Beginning in August 2012, in another unregistered transaction, Burnside began buying back outstanding shares of LTC-Global from investors who wished to sell them, some of which he resold to other investors. In September 2013, in connection with Burnside's decision to shut down the operations of both websites, Burnside agreed to buy back all outstanding shares of LTC-Global from investors. During the period from August 2012 through November 2013, Burnside purchased a total of 1,278 shares for a total of 54,798 litecoins (an average of approximately 43 litecoins per share) and 44 shares for a total of 11 bitcoins (0.25 bitcoins per share). Due to the significant rise in the exchange rate of litecoin, the total USD amount paid to investors in the buy-back transactions (approximately $142,457) exceeded the total USD amount raised (approximately $92,954).

Offer and Sale of LTC-Mining Securities

27. In two unregistered transactions in July and September 2012, Burnside offered for sale "LTC-Mining bonds," which entitled "bondholders" to an interest in the profits LTC Mining

earned from mining litecoins. Although Burnside called the investment a bond, it was in essence preferred stock that paid dividends.

28. In the first of these unregistered transactions, Burnside offered and sold 789 LTC-Mining shares for 0.43 bitcoins per share. The shares were first listed on the Global Bitcoin Stock Exchange ("GLBSE"), which purported to run a bitcoin-denominated stock exchange[4] and later on BTCT Co.'s website.[5]

29. Burnside solicited investors in the first offering by regularly posting information on the Bitcoin Forum in a thread titled "The First Perpetual LTC-Mining Bond." Burnside provided certain disclosures as part of this offering, posting extensive information about himself, how the mining operation worked, his involvement in the operation, and the terms of the offering.

30. The first LTC-Mining offering raised 339 bitcoins. Burnside used the proceeds of the offering to buy computers and specialized graphic cards to support his mining operation. At the time of the offering, 339 bitcoins were worth approximately $2,644.

31. In a second unregistered transaction in September 2012, Burnside offered and sold an additional 500 shares of "LTC-Mining bonds" for an average of 129.74 litecoins per share. Burnside offered the bonds on LTC-Global, his newly launched litecoin-denominated stock exchange and in contrast to the first unregistered LTC-Mining bond offering, sought payment in litecoins rather than bitcoins.

32. Burnside solicited investors in the second LTC-Mining bond offering through posts he made on the Bitcoin Forum. On September 27, 2012, Burnside posted that the litecoin and bitcoin-denominated LTC-Mining bonds were identical and that the only difference between the two offerings was that "you get paid [dividends] in LTC instead of BTC."

33. The second LTC-Mining bond offering raised 64,870 litecoins, which was worth approximately $2,834 at the time of the offering.

34. In June 2013, in a third unregistered transaction and almost a year after the first LTC-Mining bond offering, Burnside offered to buy back the "bonds" from all existing bondholders due to the unprofitability of the investment and the rise in value of bitcoins and litecoins. In connection with the buy-back transactions, Burnside paid LTC-Mining shareholders a total of 33,100 litecoins and 236 bitcoins. Due to the significant rise in the exchange rate of bitcoins and litecoins, the total USD amount paid to investors in the buy-back transactions (approximately $59,504) exceeded the total USD amount raised (approximately $5,490). Also,

[4] In October 2012, GLBSE ceased operations.

[5] Burnside launched BTCT Co. shortly after the GLBSE ceased operating and offered GLBSE issuers the ability to transfer their stock listings and holdings from the GLBSE to BTCT Co. at no charge. Burnside transferred his listing of LTC-Mining from GLBSE to BTCT Co. and created user accounts for all LTC-Mining shareholders.

shareholders who purchased shares in the IPO received approximately a 10% return on their investment.

Legal Analysis

35. Section 5(a) of the Securities Act provides that, unless a registration statement is in effect as to a security, it is unlawful for any person, directly or indirectly, to engage in the unregistered offer or sale of securities in interstate commerce. Section 5(c) of the Securities Act provides a similar prohibition against offers to sell, or offers to buy, unless a registration statement has been filed. Thus, both Sections 5(a) and 5(c) of the Securities Act prohibit the unregistered offer or sale of securities in interstate commerce, unless the offerings are exempt. *See* 15 USC §77e.

36. As described above, Burnside offered to buy and sell shares of LTC-Global and LTC-Mining over the Internet and was required to register the offerings with the Commission or qualify for an exemption. No registration statement was filed for the LTC-Global or LTC-Mining offerings, and no exemption from registration was applicable to these transactions. As a result, Burnside willfully violated Sections 5(a) and 5(c) of the Securities Act.

37. Section 5 of the Exchange Act makes it unlawful for any broker, dealer, or exchange, directly or indirectly, to effect any transaction in a security, or to report any such transaction, in interstate commerce, unless the exchange is registered as a national securities exchange under Section 6 of the Exchange Act, or is exempted from such registration. *See* 15 USC §78e. Section 3(a)(1) of the Exchange Act defines an "exchange" as "any organization, association, or group of persons, whether incorporated or unincorporated, which constitutes, maintains, or provides a market place or facilities for bringing together purchasers and sellers of securities or for otherwise performing with respect to securities the functions commonly performed by a stock exchange as that term is generally understood … ." 15 USC §78c(a)(1). Exchange Act Rule 3b-16 further defines an exchange to mean an organization, association, or group of persons that: (1) brings together the orders for securities of multiple buyers and sellers; and (2) uses established, non-discretionary methods (whether by providing a trading facility or by setting rules) under which such orders interact with each other, and the buyers and sellers entering such orders agree to the terms of the trade. 17 CFR 240.3b-16(a). The Commission has also stated that "an exchange or contract market would be required to register under Section 5 of the Exchange Act if it provides direct electronic access to persons located in the U.S." Exchange Act Rel. No. 34-60194 (June 30, 2009), 74 FR 32200, 32204 (July 7, 2009) (order granting exemptions).

38. As described above, Burnside and BTC Trading operated LTC-Global and BTCT Co. as "virtual stock exchanges." Section 5 of the Exchange Act required them to register both enterprises with the Commission or obtain a formal exemption from registration. Both LTC-Global and BTCT Co. operations provided issuers the ability to create and list initial and secondary securities offerings through their websites in exchange for a flat listing fee. During the relevant time period, approximately 52 issuers entered into contracts to list their shares with LTC-Global and they paid a total of 11,450 litecoins in listing fees. Approximately 69 issuers entered into contracts with BTCT Co. and paid a total of 210 bitcoins in listing fees. Registered users could also invest and trade in any listed security through each website, which used a non-

discretionary system to match and execute trades. By failing to register LTC-Global and BTCT Co. as national securities exchanges, or to obtain an exemption from such registration, Burnside and BTC Trading willfully violated Section 5 of the Exchange Act.

39. Subject to limited exceptions and exceptions not applicable to Burnside and BTC Trading, Section 15(a)(1) of the Exchange Act makes it unlawful for any broker or dealer "to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale, of any security ... unless such broker or dealer is registered" in accordance with Section 15(b) of the Exchange Act. 15 USC §78o. Section 3(a)(4) of the Exchange Act defines a "broker" as a person, including a company, engaged in the business of effecting transactions in securities for the account of others. A person is engaged in the business of effecting securities transactions if he or she regularly "participates in securities transactions at key points in the chain of distribution." *See Massachusetts Fin. Servs., Inc. v. Sec. Investor Prot. Corp.*, 411 F. Supp. 411, 415 (D. Mass. 1976), *aff'd*, 545 F.2d 754 (1st Cir. 1976). Such participation includes, among other activities, assisting an issuer to structure prospective securities transactions, helping an issuer to identify potential purchasers of securities, and soliciting securities transactions. *See Strengthening the Commission's Requirements Regarding Auditor Independence*, Exch. Act Rel. No. 34-47265 (Jan. 28, 2003), 68 FR 6006, 6014-15 n.82 (Feb. 5, 2003) (adopting release).

40. As described above, LTC-Global's and BTCT Co.'s business, directed by Burnside, was to effect transactions in securities for the accounts of others. BTC Trading, directed by Burnside, actively solicited the public to open accounts by advertising the websites on the Bitcoin Forum and other websites dedicated to virtual currency. As a result of these solicitation efforts, during the relevant operating periods, approximately 2,655 users opened online accounts with LTC-Global and executed approximately 60,496 trades through the website, paying a total of 12,081 litecoins in transaction-based compensation. Approximately 7,959 users opened online accounts with BTCT Co. and executed approximately 366,490 trades through the website, paying a total of 2,141 bitcoins in transaction-based compensation. As a result of this conduct, Burnside and BTC Trading were required to register with the Commission as a broker or dealer. By failing to register as a broker or dealer and as a result of their conduct described in this Order, Burnside and BTC Trading willfully violated Section 15(a) of the Exchange Act.

Respondents' Remedial Efforts

In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondents and cooperation afforded the Commission staff. Beginning in September 2013, in immediate response to the Commission staff's investigation, Burnside began an orderly wind down of both websites. Since September 2013, users have withdrawn funds totaling approximately 200,000 litecoins and 20,000 bitcoins, and in October 2013, both websites ceased operating. Throughout the investigation, Burnside fully cooperated with the Commission staff, providing early and substantial assistance. He made himself available to Commission staff upon request, translated data into accessible formats while producing the raw data to permit independent verification, and he retained financial audit experts to assist in the generation and formatting of reports in order to enable the staff to quickly ascertain the scope and operation of his enterprises. Burnside's efforts facilitated the staff's investigation involving an emerging technology.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offer.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b), and 21C of the Exchange Act, and Section 9(b) of the Investment Company Act, it is hereby ordered that:

A. Respondent Burnside cease and desist from committing or causing any violations and any future violations of Sections 5(a) and 5(c) of the Securities Act.

B. Respondents Burnside and BTC Trading cease and desist from committing or causing any violations and any future violations of Sections 5 and 15(a) of the Exchange Act.

C. Respondent Burnside be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock;

with the right to apply for reentry after two (2) years to the appropriate self-regulatory organization, or if there is none, to the Commission.

D. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

E. Respondent Burnside shall pay disgorgement, which represents profits gained as a result of the conduct described herein, of $55,000 and prejudgment interest of $3,387.07, for a total of $58,387.07, to the Securities and Exchange Commission for transfer to the United States Treasury. Payments shall be made in the following installments.

(1) $10,000 within ten days of the entry of this Order;

(2) $24,193.54 within 180 days of entry of the Order; and

(3) $24,193.54 plus prejudgment interest on the payments described in Section IV.E(2) and IV.E.(3) pursuant to SEC Rule of Practice 600, within 360 days of entry of the Order.

Prior to making the payment described in Section IV.E(3), Respondent Burnside shall contact the Commission staff to ensure the inclusion of prejudgment interest. If any payment is not made by the date the payment is required by this Section IV.E, the entire outstanding balance of disgorgement, prejudgment interest, plus any additional interest accrued pursuant to SEC Rule 600, shall be due and payable immediately, without further application.

F. Respondent Burnside shall, within 10 days of this Order, pay civil money penalties of $10,000 to the Securities and Exchange Commission for transfer to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. §3717.

G. Payments under this Order must be made in one of the following ways:

1. Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

2. Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

3. Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Ethan Burnside and BTC Trading, Corp. as Respondents in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Valerie A. Szczepanik, Assistant Regional Director, Division of Enforcement, Securities and Exchange Commission, New York Regional Office, Brookfield Place, 200 Vesey Street, Suite 400, New York, NY 10281-1022, or such other person or address as the Commission staff may provide.

H. Respondents acknowledge that the Commission is not imposing a civil penalty in excess of $10,000 based upon their cooperation in a Commission investigation. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondents knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, the Division may, at its sole discretion and with prior notice to the Respondents, petition the Commission to reopen this matter and seek an order directing that the Respondents pay an additional civil penalty. Respondents may contest by way of defense in any resulting administrative proceeding whether it knowingly provided materially false or misleading information, but may not: (1) contest the findings in the Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Burnside, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Burnside under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Burnside of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3975 / December 9, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16308

In the Matter of Paul A. Ligor, Jr., Respondent.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against Paul A. Ligor, Jr. ("Ligor" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2. below, which is admitted, Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that

1. Beginning in at least December 2009, Ligor was associated with Ajax Investment Advisors, LLC, an investment adviser with its principal place of business in Sebago, Maine. From May 1985 through June 2010, Ligor was intermittently a registered representative associated with various broker-dealers. Ligor, 59 years old, is a resident of Denmark, Maine.

2. On March 31, 2014, the State of Maine Office of Securities issued a Consent Order ("Maine Order") in an administrative action entitled *In Re: Paul A. Ligor, Jr.*, Case No. 11-7629. The Maine Order barred Ligor from associating with any issuer, broker-dealer or investment adviser in Maine, from acting as an investment adviser or investment adviser representative in Maine when not licensed to do so, and from otherwise violating Maine securities laws. Ligor was also ordered to pay a civil fine of $1,000.

3. The Maine Order alleges that from 2009 through early 2011, Ligor actively managed and executed trades in self-directed brokerage accounts on behalf of at least eight clients while not being appropriately licensed as an investment adviser. Further, the order alleges that while engaging in this unlicensed investment advisory activity, Ligor made a false statement to Maine's Office of Securities in 2009 by affirming that he would not render professional services until his pending application was approved and the proper license to do business as an investment adviser representative was issued.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Ligor's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act, that Respondent Ligor be, and hereby is:

> barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73798 / December 9, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16309

In the Matter of **ROBERT A. WALKER,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Robert A. Walker ("Walker" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, Respondent admits the Commission's jurisdiction over him and the subject matter of these proceedings, and the findings contained in Sections III.2 below, and consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. From 2001 to 2011, Walker was the founder, President, Chief Executive Officer, and Chairman of the Board of Directors of Bixby Energy Systems, Inc. ("Bixby"), a privately held Delaware corporation with its principal place of business in Ramsey, Minnesota. Although Walker was not registered as a broker-dealer with the Commission during the relevant period, Walker was associated with a broker or dealer based on, among other things, his offering and paying commissions to individuals who solicited investments on behalf of Bixby. During the relevant period, Walker was a resident of Anoka, Minnesota. Walker, 72, is currently remanded to the custody of the U.S. Marshal.

2. On March, 5, 2014, a jury found Walker guilty of: four counts of mail fraud (18 U.S.C. § 1341), eight counts of wire fraud (18 U.S.C. § 1343), one count of conspiracy to commit mail and wire fraud (18 U.S.C. § 1349), one count of witness tampering (18 U.S.C. § 1512(b)(1)), and three counts of tax evasion (26 U.S.C. §7201), in a criminal action brought before the United States District Court for the District of Minnesota captioned *United States v. Walker*, 11-CR-381. On September 25, 2014, Walker was sentenced to a prison term of 300 months followed by three years of supervised release and ordered to make restitution in the amount of $57,967,186.03.

3. The counts of the criminal indictment on which Walker was found guilty alleged, *inter alia*, that Walker, by use of the United States mails and interstate wire communications, fraudulently obtained money and property by means of material misrepresentations and omissions to investors and prospective investors regarding: the payment of commissions to company officers for their sale of Bixby securities; the operating capability of Bixby's coal gasification and liquefaction technologies; the status of the company's efforts to go public, and the criminal history of Bixby's former Chief Financial Officer, Dennis DeSender. The indictment also alleged that Walker unlawfully offered and paid commissions to individuals who solicited investments on behalf of Bixby.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Walker's Offer.

Accordingly, it is hereby ORDERED pursuant to Section 15(b)(6) of the Exchange Act that Respondent Walker be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73802 / December 10, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16310

In the Matter of MORGAN STANLEY & CO. LLC Respondent.	CORRECTED ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS, PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Morgan Stanley & Co. LLC ("MS & Co." or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Summary

1. The subject of these proceedings is MS & Co.'s violation of Exchange Act Rule 15c3-5 ("Rule 15c3-5" or the "Market Access Rule"), which requires brokers or dealers to establish, document, and maintain a system of risk management controls and supervisory procedures reasonably designed to manage the financial, regulatory, and other risks associated with providing customers access to the markets. MS & Co. is a registered broker-dealer that offers its institutional customers direct market access through an electronic trading desk that is part of the firm's Institutional Equity Division (Morgan Stanley Electronic Trading, or "MSET").

2. One requirement of the Market Access Rule is that broker-dealers reasonably design controls and supervisory procedures to prevent the entry of orders that exceed pre-set aggregate credit thresholds for customers. The Commission adopted the Market Access Rule, in part, to require that brokers or dealers, as gatekeepers to the financial markets, "appropriately control the risks associated with market access, so as not to jeopardize their own financial condition, that of other market participants, the integrity of trading on the securities markets, and the stability of the financial system."[2] The requirement that a broker-dealer establish automated pre-trade aggregate credit thresholds is important because such limits "should protect broker-dealers providing market access, as well as their customers and other market participants, by blocking orders that do not comply with applicable risk management controls from being routed to a securities market."[3]

3. The events of October 25, 2012 revealed that MS & Co.'s controls and supervisory procedures were not reasonably designed to prevent the entry of orders that exceed pre-set aggregate credit thresholds for customers. On that day, MSET twice increased pre-set aggregate credit thresholds for its customer Rochdale Securities LLC ("Rochdale") (a registered broker-dealer that accessed MSET's platform on behalf of its own institutional customers), initially from $200 million to $500 million and subsequently from $500 million to $750 million, when it received a series of orders for approximately $525 million of Apple, Inc. ("Apple") stock—an amount that would have exceeded Rochdale's threshold had it not been increased by MSET. Unbeknownst to MSET, David Miller ("Miller"), the registered representative at Rochdale with whom MSET personnel were interacting on October 25, 2012, was using these orders to commit fraud. A Rochdale customer purportedly instructed Miller to purchase 1,625 shares of Apple. Miller instead purchased 1,625,000 shares of Apple at a cost of almost $1 billion, scheming to personally profit by sharing the anticipated proceeds with the customer if Apple's stock price increased. Miller falsely informed Rochdale that he was trading on behalf of a customer. Approximately 860,200 of the Apple shares Miller purchased were executed through MSET, and Miller falsely informed MSET that these trades were on behalf of a Rochdale customer. When Apple's stock price began dropping, and it became clear that the trades would not be profitable,

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[2] Risk Management Controls for Brokers or Dealers with Market Access, 75 Fed. Reg. 69792, 69792 (Nov. 15, 2010) (final rule release).

[3] *Id.* at 69801.

Miller falsely claimed that he had made a mistake, leaving Rochdale holding the unauthorized purchase and suffering a loss of approximately \$5.3 million.[4]

4. As explained when the Commission adopted the Market Access Rule, a broker-dealer should make determinations of appropriate credit thresholds for each customer for which it provides market access "based on appropriate due diligence as to the customer's business, financial condition, trading patterns, and other matters, and document that decision. In addition, the Commission expects the broker-dealer will monitor on an ongoing basis whether the credit thresholds remain appropriate, and promptly make adjustments to them, and its controls and procedures, as warranted."[5]

5. Beginning in November 2011 and continuing through at least October 25, 2012 (the date on which MS & Co. twice increased aggregate credit thresholds for Rochdale), MS & Co.'s system of risk management controls and supervisory procedures was not reasonably designed to manage the risks associated with the market access it provided and, as a result, MS & Co. violated the Market Access Rule. In particular, MS & Co. did not have reasonably designed controls and supervisory procedures because those controls and procedures, as reflected in MS & Co.'s Rule 15c3-5 written supervisory procedures ("WSPs"), did not reasonably guide MSET personnel in determining whether to modify the customer credit thresholds that are required under Rule 15c3-5(c)(1)(i), including in situations in which personnel were confronted with a customer order to purchase equity securities in an amount that exceeded the threshold. As a result of these inadequate controls and procedures, MS & Co. twice increased Rochdale's aggregate credit threshold on October 25, 2012 without appropriate due diligence to ensure that the credit increases were warranted.

Respondent

6. Morgan Stanley & Co. LLC ("MS & Co.") is a U.S.-based broker-dealer and a wholly-owned subsidiary of Morgan Stanley. MS & Co. is registered with the Commission pursuant to Section 15 of the Exchange Act and is a Financial Industry Regulatory Authority member. MS & Co. has its principal business operations in New York, New York. Morgan Stanley Electronic Trading ("MSET") is a trading desk within MS & Co.'s Institutional Equity Division that offers its customers direct market access.

MS & Co.'s Rule 15c3-5 Written Supervisory Procedures and Controls

7. MS & Co.'s Rule 15c3-5 WSPs from approximately November 2011 until at least October 25, 2012 required the firm to establish pre-trade single order thresholds and aggregate credit thresholds for new MSET customer accounts. Single order thresholds included trading limits

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[4] Miller was charged both civilly and criminally for his actions. *See SEC v. David Miller*, Case No. 3:13-cv-00522-JBA (D. Conn.), Litigation Rel. No. 22671 (April 15, 2013) and *United States v. David Miller*, No. 3:13-cr-00075 (D. Conn.), Litigation Rel. No. 22872 (Nov. 21, 2013). On November 19, 2013, Miller was sentenced to 30 months' imprisonment, followed by three years of supervised release.

[5] 75 Fed. Reg. at 69802.

established for new customers based on the maximum order size that a customer may submit in a single order, set at both a share level (total number of shares that a customer may submit in a single order) and "notional dollar" level (the maximum dollar size of a single order defined as share price multiplied by share quantity). Aggregate credit thresholds were daily trading limits for a customer based on parameters including: (a) total number of shares traded during a day; (b) notional net value of trades during a day (purchases less sales); and (c) notional gross value of trades during a day (purchases plus sales).

8. Single order thresholds were configured as either "hard" or "soft" in Client Flow Manager ("CFM"), MSET's risk management proprietary software which launched automatically on the computers of all MSET client coverage personnel each morning. Hard thresholds in CFM rejected a customer order outright if the order exceeded the single order pre-set threshold. Soft thresholds in CFM held a customer order from being routed to the market by generating an alert to the account representative who could either release the order to the market or reject the order back to the customer. MSET determined whether to set single order thresholds as soft or hard (or a combination of both). Aggregate credit thresholds were always configured as hard in CFM. As such, orders whose parameters exceeded the aggregate credit thresholds could not be released to the market without modification of the threshold.

9. MS & Co.'s WSPs required it to document the hard thresholds, including both hard single order thresholds and the hard aggregate credit thresholds established pursuant to Rule 15c3-5. These hard thresholds could be modified (e.g., increased) subject to supervisory approval. MS & Co.'s WSPs also required the approval and the reason for the modification to be documented. The process in practice occurred as follows: (i) an MSET account representative (typically in direct contact with a customer) would request that a desk supervisor sitting nearby enter an increase to the customer's hard threshold; (ii) that desk supervisor would then enter the threshold change in MSET's system along with a reason for the change (choosing from a drop-down menu in MSET's computer system without further annotation or explanation); and (iii) a separate desk supervisor would then confirm the threshold change in the system in order for it to take effect. A number of MSET supervisors were authorized to enter and/or confirm requests to increase hard thresholds.

10. During the relevant period, MS & Co.'s WSPs did not contain guidance or criteria on what factors to consider, if any, when evaluating whether to modify a customer's single order threshold or aggregate credit threshold.

11. During the relevant period, the most common documented reason for increasing a customer's aggregate credit threshold was "trading style," which was one of several choices in the drop-down menu. According to relevant MSET personnel, "trading style" was a general term encompassing the manner in which a customer was trading on a particular day.

The October 25, 2012 Event and Aftermath

12. When Rochdale, a registered broker-dealer, first became an MSET customer in mid-2009, MSET placed Rochdale into a non-customized "starter bucket" with a $200 million

aggregate credit threshold. At that time, MS & Co.'s WSPs did not contain guidelines, criteria, or other qualifications to use when determining initial aggregate credit thresholds for a customer.

13. On October 25, 2012, the day of an Apple earnings announcement, Miller, a registered representative at Rochdale, entered a series of purchase orders in Rochdale's internal entry system totaling 1,625,000 shares of Apple at a cost of almost $1 billion. Ultimately, approximately 860,200 of the Apple shares purchased by Miller were executed by MSET for an aggregate value of approximately $525 million.

14. At the time, Rochdale was subject to the $200 million aggregate credit threshold. To accommodate Miller's orders, MSET twice raised Rochdale's aggregate credit threshold concerning the maximum notional net value Rochdale could trade—first from $200 million to $500 million at approximately 12:39 p.m. and then from $500 million to $750 million at approximately 3:23 p.m.[6] Both increases occurred after brief conversations between the MSET account representative, who was in direct communication with Miller by instant message, and an MSET desk supervisor sitting near the account representative who entered (or directed a colleague to enter) the increase. Miller did not know that Rochdale's aggregate credit thresholds were being approached (and he did not seek the increases); rather, the MSET account representative requested the increases of her supervisor upon determining that Miller's order flow would exceed the existing threshold and upon confirming with Miller that the orders were not erroneously entered. MSET did not inform Miller (or anyone else at Rochdale) that MSET was increasing Rochdale's aggregate credit threshold. MS & Co.'s WSPs contained no criteria or guidance for MSET personnel to consider in deciding whether to modify Rochdale's aggregate credit threshold. As a result, MSET personnel twice increased Rochdale's aggregate credit threshold without appropriate due diligence to ensure that the credit increases were warranted.

15. Miller's Apple trades through MSET also generated 20 single order "soft" threshold alerts between 10:59 a.m. and 3:50 p.m. that day. (Nineteen single orders were above Rochdale's $10,000,000 single order threshold and one single order contained an erroneous price entry.) MSET personnel allowed all 20 orders to be sent to the market within seconds of receiving each alert (e.g., the alert received at approximately 11:22:53 a.m. was released at approximately 11:23:02 a.m.).[7] MS & Co.'s WSPs contained no criteria or guidance for MSET account representatives to consider in deciding whether to release single order soft threshold alerts.

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[6] MSET previously modified Rochdale's aggregate credit threshold on various dates before October 25, 2012: February 22, 2010, February 4, 2011, August 30, 2011, April 2, 2012, and April 3, 2012. The largest aggregate credit threshold increase during this period was April 2, 2012, when MSET increased Rochdale's net threshold from $200 million to $500 million (and then back to $200 million on April 3). MS & Co. produced no documentation of any refusal by MSET to raise the aggregate credit threshold when confronted with a customer order to purchase equity securities in an amount that exceeded the threshold.

[7] MSET previously modified Rochdale's single order threshold on six dates during 2009 and 2010. For example, on August 4, 2010, MSET increased Rochdale's single order threshold from $10 million to $25 million, and on December 9 and 10, 2010, from $40 million to $50 million. MSET typically coded these single order threshold increases as "due to increased client trading volume."

16. Neither the initial increase to Rochdale's aggregate credit threshold (from $200 million to $500 million) nor the numerous prior single order soft threshold alerts were considered by MSET personnel in connection with the second decision to increase Rochdale's aggregate credit threshold. Moreover, MSET's documented reason for increasing Rochdale's aggregate credit threshold on both occasions was "trading style," which was one of several choices in the drop-down menu. One MSET supervisor who confirmed Rochdale's aggregate credit threshold increases incorrectly believed MSET's credit thresholds were in place primarily to prevent against erroneous orders ("fat finger" errors).

17. Unbeknownst to MSET, the Rochdale customer on whose behalf Miller was purchasing Apple had purportedly authorized Miller to purchase only 1,625 shares. Miller's order for many multiples of what was written in Rochdale's customer order was in fact part of a fraudulent scheme to personally profit by sharing the anticipated proceeds with the customer if Apple's stock price increased following the earnings announcement. When Apple's stock price began dropping later that day, and it became clear that the trades would not be profitable, Miller falsely claimed that he had made a mistake.

18. As a result of Miller's actions, Rochdale purchased 1,625,000 shares of Apple. Rochdale promptly traded out of the position, but, as a result of the decrease in stock price, suffered a loss of approximately $5.3 million by the following day. Regulatory net capital requirements prohibited Rochdale from continuing to trade securities, and Rochdale ceased all business operations in approximately February 2013.

VIOLATIONS

19. Section 15(c)(3) of the Exchange Act, among other things, prohibits a broker or dealer from effecting any securities transaction in contravention of the rules and regulations the Commission prescribes as necessary or appropriate in the public interest, or for the protection of investors, to provide safeguards with respect to the financial responsibility and related practices of brokers or dealers. MS & Co. violated this Section through its violations, described below, of a rule promulgated by the Commission thereunder.

20. Subsection (c)(1)(i) of Rule 15c3-5 requires that a broker or dealer's risk management controls and supervisory procedures shall be reasonably designed to prevent the entry of orders that exceed appropriate pre-set credit thresholds in the aggregate for each customer. The adopting release for the Market Access Rule explained that credit thresholds would be "based on appropriate due diligence as to the customer's business, financial condition, trading patterns, and other matters," that decisions on credit thresholds would be documented, and that "the Commission expects the broker-dealer will monitor on an ongoing basis whether the credit thresholds remain appropriate, and promptly make adjustments to them, and its controls and procedures, as warranted."[8] MS & Co.'s controls and procedures, as reflected in its WSPs, were not reasonably designed to prevent the entry of orders that exceed pre-set aggregate credit thresholds for customers because they did not reasonably guide decisions regarding possible modifications of

[8] 75 Fed. Reg. at 69802.

customer aggregate credit thresholds. As a result, MS & Co. twice increased Rochdale's aggregate credit threshold without appropriate due diligence to ensure that the credit increases were warranted.

21. Based on the foregoing, the Commission finds that MS & Co. willfully[9] violated Section 15(c)(3) of the Exchange Act and Rule 15c3-5 thereunder.

REMEDIAL EFFORTS

22. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Respondent and cooperation afforded the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, and for the protection of investors to impose the sanctions agreed to in Respondent MS & Co.'s Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act, it is hereby ORDERED that:

A. Respondent MS & Co. cease and desist from committing or causing any violations and any future violations of Section 15(c)(3) of the Exchange Act and Rule 15c3-5 thereunder.

B. Respondent MS & Co. is censured.

C. Pursuant to Section 21B(a)(1) and (2) of the Exchange Act, Respondent MS & Co. shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $4,000,000 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. § 3717. Such payment must be made in one of the following ways: (1) Respondent MS & Co. may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) Respondent MS & Co. may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or (3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

[9] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting *Hughes v. SEC*, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" *Id.* (quoting *Gearhart & Otis, Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965)).

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying MS & Co. as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Daniel M. Hawke, Chief, Market Abuse Unit, Division of Enforcement, Securities and Exchange Commission, Philadelphia Regional Office, One Penn Center, 1617 JFK Boulevard, Suite 520, Philadelphia, PA 19103.

By the Commission.

Brent J. Fields
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9686 / December 10, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73801 / December 10, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3976 / December 10, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31367 / December 10, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16311

In the Matter of **RELIANCE FINANCIAL ADVISORS, LLC, TIMOTHY S. DEMBSKI and WALTER F. GRENDA, JR.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(e), 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(e), 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Reliance Financial Advisors, LLC ("Reliance Financial"), Timothy S. Dembski ("Dembski") and Walter F. Grenda, Jr. ("Grenda," and together with Reliance Financial and Dembski, "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. This case involves misconduct by Dembski and Grenda, founders and joint owners of Reliance Financial, an investment adviser registered with the Commission. Dembski and Grenda each made (or used) false and misleading statements to their advisory clients at Reliance Financial in recommending and selling investments in a risky hedge fund—Prestige Wealth Management Fund, LP ("Prestige Fund" or the "Fund"), that Dembski founded along with his long-time friend, Scott M. Stephan ("Stephan").

2. Dembski and Stephan co-owned Prestige Wealth Management, LLC ("Prestige" or "General Partner"), the General Partner to the Prestige Fund. The Prestige Fund's trading strategy was described to prospective investors as being fully-automated with all trades being made according to, and by, a computer algorithm (the "Algorithm").

3. Dembski and Grenda both sold interests in the Prestige Fund exclusively to long-standing clients of their investment advisory and tax preparation services at Reliance Financial, and at its predecessor entity, Reliance Financial Group ("Reliance Group"). As Dembski and Grenda understood from advising these advisory and/or tax clients over the years, many of them were retired or near retirement, on fixed incomes, and lacked investment acumen.

4. As Dembski and Grenda knew or recklessly disregarded, the Prestige Fund was a highly speculative, risky investment. Indeed, neither Dembski nor Stephan had any experience in managing a hedge fund and, in Stephan's case, virtually no investing experience at all.

5. Nonetheless, Dembski and Grenda knowingly or recklessly made or used false and misleading statements to their advisory clients in order to create the false appearance that an investment in the Prestige Fund was less risky than it really was. For example:

   a. Dembski and Grenda provided their clients with a private placement memorandum (the "PPM") that they knew or recklessly disregarded greatly exaggerated Stephan's experience in the securities industry;

   b. Dembski led certain of his clients to believe (falsely) that he both created the Algorithm and monitored the Fund's performance on a regular (sometimes daily) basis in order to comfort those investors that their risk of loss was limited; and

   c. Dembski also created the false impression for certain of his clients that sophisticated institutional investors were interested in acquiring the Algorithm.

6. Dembski's and Grenda's respective clients trusted them. Thus, at their recommendations, Dembski's and Grenda's clients, respectively, invested approximately $4 million and $8 million in the Prestige Fund. The Prestige Fund started trading in April 2011.

7. The Prestige Fund did not, however, have positive returns as advertised. In approximately October 2012 (approximately 18 months after the Fund started trading), Grenda withdrew his clients from the Prestige Fund. Then, in approximately December 2012, the Prestige Fund collapsed, losing approximately 80% of its value, as a result of Stephan placing manual trades, contrary to the automated trading strategy sold to investors. Thus, Dembski's client lost the vast majority of their investments.

8. In addition, between September 2009 and December 2009, Grenda also borrowed $175,000 from two of his advisory clients (a mother and a daughter), telling them that he would use the loan to grow his business. That was not true, as Grenda knew or recklessly disregarded. Instead, Grenda used the money to, among other things, pay personal expenses and debts.

B. RESPONDENTS

9. **Reliance Financial Advisors, LLC** is a Buffalo-based investment adviser that registered with the Commission in January 2011. Dembski and Grenda founded and, during the relevant time period, jointly owned Reliance Financial.

10. **Timothy S. Dembski**, age 42, resides in Lancaster, New York. In January 2011, Dembski co-founded and was Managing Partner at Reliance Financial, an investment adviser registered with the Commission. Also in early 2011, Dembski co-founded the Prestige Fund and its General Partner, Prestige. Prior to founding Reliance Financial and the Prestige Fund, Dembski provided investment advisory services to individual clients in his role at Reliance Group. In addition, from approximately October 2006 through March 2011, Dembski was a registered representative associated with a registered broker-dealer ("BD1"). From approximately September 2011 to July 2013, Dembski was a registered representative with another registered broker-dealer ("BD2").

11. **Walter F. Grenda, Jr.**, age 57, resides in Buffalo, New York. In January 2011, Grenda co-founded and was Managing Partner at Reliance Financial, an investment adviser registered with the Commission. Prior to founding Reliance Financial, Grenda provided investment advisory services to individual clients in his role at Reliance Group. In addition, Grenda was a registered representative with BD1 from approximately October 2006 through March 2011 and with BD2 from approximately September 2011 through July 2013.

C. OTHER RELEVANT PEOPLE AND ENTITIES

12. **Scott M. Stephan**, age 40, resides in Hamburg, New York. Stephan co-founded the Prestige Fund and the General Partner in early 2011 and was the Fund's Chief Investment Officer and sole portfolio manager. Prior to founding the Prestige Fund, Stephan worked at the Reliance Group and was a registered representative with BD1 from approximately June 2009 through March 2011.

13. **Prestige Wealth Management Fund, LP**, was a private investment fund under the Investment Company Act and organized as a limited partnership under Delaware law on November 19, 2010.

14. **Prestige Wealth Management, LLC**, was a limited liability company organized in Delaware on November 12, 2010, and adviser to the Prestige Fund. Dembski and Stephan were the sole members of Prestige (which served as the General Partner to the Prestige Fund), each owning 50%. Prestige charged the Prestige Fund a 2% management fee and a 20% performance fee on an annualized basis. Prestige was not registered with the Commission.

15. **Reliance Financial Group**, was a Buffalo-based investment adviser founded and jointly owned by Dembski and Grenda from 1998 to 2011. Reliance Group was not registered with the Commission. Dembski and Grenda transferred their advisory clients from Reliance Group to Reliance Financial starting in approximately February 2011.

FACTS

D. DEMBSKI AND GRENDA HIRE STEPHAN TO WORK AT RELIANCE GROUP

16. In approximately April 2007, Dembski hired Stephan to work for him and Grenda at Reliance Group. Dembski and Stephan were long-time friends; Dembski was godfather to at least one of Stephan's children. When Stephan first started working for Dembski and Grenda, Stephan had no professional experience in the securities industry, trading securities, investing, or providing investment advice to others. Virtually all of Stephan's professional experience to that point had been collecting on—and managing others who collected on—past-due car loans. Dembski and Grenda knew of (or recklessly disregarded) Stephan's prior work experience and that he had no experience in securities or investments when he was hired to work at Reliance Group.

17. Dembski and Grenda hired Stephan to assist them with telemarketing efforts for the services they offered at Reliance Group. In that role, Stephan's job was to locate new investment advisory clients for Dembski and Grenda through, among other things, placing cold calls and arranging sales seminars.

18. At no point, however, did Stephan provide Reliance Group's clients with investment advice, trade securities, or make investment decisions. At most, Stephan—from time to time—discussed investment ideas with Reliance Group's college interns, and assisted Grenda with various research tasks.

E. DEMBSKI AND STEPHAN SET UP THE PRESTIGE FUND

19. In Summer 2010, Stephan approached Dembski about establishing a hedge fund to undertake an automated trading strategy of Stephan's own design, the Algorithm. The Algorithm purportedly had the following features:

a. It operated as a day-trading strategy that would hold no securities overnight;

b. It was designed to automatically buy or sell stocks and interests in Exchange Traded Funds ("ETFs") at pre-programmed times of the day and according to pre-programmed market signals; and

c. It was supposed to automatically enter a long position on a chosen stock or ETF should it go up approximately 1 to 1.5 percent and it would automatically enter a short position on a chosen stock or ETF should it go down approximately 1 to 1.5 percent. Once in a position, the Algorithm automatically would exit it after a 3 percent gain or a 1 percent loss, respectively.

20. Dembski and Stephan did not undertake any real-time testing of the Algorithm, for example, by investing funds using its formula to see how it performed under actual market conditions. At most, they "back tested" the Algorithm, *i.e.*, looked at certain securities trading in the past to see how the Algorithm would have performed had it actually placed trades in those securities over those periods.

21. Neither Dembski nor Stephan had any experience establishing or running a hedge fund or in algorithmic or other automated trading strategies, a fact Grenda also knew or recklessly disregarded after working with them for years. Indeed, as discussed above, Stephan had little-to-no experience managing client funds or making investments. Nonetheless, Dembski and Stephan decided to set up the Prestige Fund to trade based on the Algorithm.

22. Dembski and Stephan hired a law firm (the "Law Firm") to advise them on the process of setting up the hedge fund, including to assist them in preparing the necessary fund documents, including the PPM, limited partner agreements, and subscription agreements.

23. Based on discussions that he had with the Law Firm, Dembski understood that—because of his role with Reliance Financial, a soon-to-be registered investment adviser—he and Stephan would need to register Prestige with the Commission unless Dembski avoided having anything to do with the day-to-day management of the Prestige Fund. Dembski and Stephan agreed that Dembski would have no day-to-day involvement in the Fund.

24. Thus, even before the Prestige Fund began operations, Dembski planned to have no involvement in managing its trading affairs. Indeed, to maintain this separation, Dembski did not even check on the Prestige Fund's performance or receive its quarterly account statements with any regularity.

25. In or about November 2010, Dembski and Stephan established Prestige and the Prestige Fund (the former of which served as General Partner and adviser to the Fund).

26. Grenda recommended the Fund to his advisory clients. He also played an active role in reviewing the fund documents (including the PPM). It was Grenda's intention and hope that after the Prestige Fund proved successful, Dembski and Stephan would eventually include him as an owner. In anticipation of this, at times he referred to himself as the "president" of, or a "partner" in, the Prestige Fund.

F. DEMBSKI AND GRENDA RECOMMEND AND SELL INVESTMENTS IN THE PRESTIGE FUND TO THEIR ADVISORY CLIENTS

27. From about February 2011 to September 2012, Dembski and Grenda raised approximately $12 million selling interests in the Prestige Fund. The Prestige Fund's investors were comprised of Dembski's and Grenda's advisory clients at Reliance Financial and its predecessor entity, as well as clients for whom Dembski prepared tax return filings. Ultimately, Dembski procured approximately $4 million in investments for the Prestige Fund from approximately 19 of his advisory or tax clients, while Grenda procured approximately $8 million in investments from approximately 23 of his advisory clients.

28. To come up with the money to invest in the Prestige Fund, certain of Grenda's advisory clients had to cash in variable annuities, for which they incurred approximately $290,000 in surrender fees.

29. Dembski and Grenda had provided investment and/or tax preparation advice to many of their respective clients for years prior to their investing in the Prestige Fund. They, therefore, understood their clients' financial conditions and knew that many were unsophisticated investors, who were retired or nearing retirement. In addition, as Dembksi and Grenda understood, their clients trusted Dembski and Grenda to prudently manage their finances.

30. In recommending and selling investments for the Prestige Fund, Dembski and Grenda told their advisory clients, among other things, that the Prestige Fund's trading would be fully automated and directed by the Algorithm.

31. Dembski also told some prospective investors that they could make upwards of 20% on their investment per year.

G. DEMBSKI AND GRENDA MAKE OR DISTRIBUTE MATERIALLY FALSE AND MISLEADING STATEMENTS WHEN RECOMMENDING AND SELLING INVESTMENTS IN THE PRESTIGE FUND

32. In selling the Prestige Fund, Dembski and Grenda knew or recklessly disregarded: (a) that the Fund was a speculative investment; (b) that Stephan, the Algorithm's creator, had no prior experience running an algorithmic trading platform or hedge fund and, indeed, had virtually no experience trading or investing at all; and (c) that Dembski's and Grenda's advisory clients did not know Stephan and, thus, had no reason to trust or invest with him.

33. Nonetheless, Dembski and Grenda made or disseminated to their advisory clients and other investors or prospective investors in the Prestige Fund, a number of materially false and misleading statements in order to create the appearance that the Prestige Fund was a relatively safe, in-demand investment, overseen by professional money managers.

Dembski and Grenda Knew or Recklessly Disregarded that Stephan's Biography in the PPM was False and Misleading

34. Prestige Fund's PPM, dated February 1, 2011, contained the following biography for Stephan:

> Scott M. Stephan is co-founder and Chief Investment Officer of the General Partner. He has exclusive responsibility to make the Fund's investment decisions on behalf of the General Partner. Mr. Stephan has worked in the financial services industry for over 14 years. The first half of his career he co-managed a portfolio of over $500 million for First Investors Financial Services. Afterwards, Mr. Stephan took a position as Vice President of Investments for a New York based investment company in which he was responsible for portfolio management and analysis.

35. The PPM's description of Stephan's professional experiences prior to joining Reliance Group as well as his being "responsible for portfolio management and analysis" at Reliance Group were highly misleading, if not outright false. *First*, as discussed above, Stephan had no experience in the securities industry prior to joining Reliance Group in 2007. From 1999 to 2007, Stephan was responsible for collecting, or managing a group that collected, on past due car loans. This involved managing a group within a debt-collection call center, reaching out to debtors to obtain payment, and recommending cars to be repossessed in the event of non-payment. In that position, Stephan undertook no trading, managed no securities portfolios, provided no investment advice, and made no decisions concerning securities investments. Moreover, Stephan had no responsibility for determining what car loans to purchase and the value of the loans he was responsible for collecting was far less than $500 million.

36. *Second*, upon joining Reliance Group, Stephan had little-to-no experience selecting or making investments. Indeed, Dembski and Grenda hired him to undertake telemarketing efforts. Stephan received his securities Series 7, 63 and 66 licenses only in 2009 and, even then, he advised no clients of his own, undertook no trading, and had no control over the portfolios of the Reliance Group's clients. In fact, Stephan's only trading experience was investing approximately $1,000 that his father loaned to him in or around 2006 or 2007, which Stephan lost.

37. Dembski—who sent a draft of Stephan's biography to the Law Firm for inclusion in the PPM on December 13, 2010 and was thus aware of (or recklessly disregarded) its contents—knew or recklessly disregarded that Stephan's biography was false and/or misleading. Dembksi, having been a close friend of Stephan's for years and, having hired Stephan to work at Reliance Group, was aware of Stephan's professional experiences. He knew or recklessly disregarded that Stephan had no prior experience in the securities industry, that he received his securities licenses only in 2009, and that, even at Reliance Group, the so-called "New York based investment company" in the biography, Stephan had a minimal, if any, involvement managing assets, trading securities, or providing investment advice to clients.

38. Similarly, Grenda knew about Stephan's professional background prior to joining Reliance Group as well as his role at Reliance Group. Therefore, Grenda—who read and approved the PPM and then gave it to advisory clients when recommending and selling the Prestige Fund to

them—knew or recklessly disregarded that Stephan's biography was false and misleading for the same reasons as Dembski. Despite this, Grenda failed to inform his advisory clients that Stephan's biography was false and misleading or otherwise to tell them the truth concerning Stephan's work experience.

39. Nonetheless, Dembski and Grenda distributed the PPM to investors and prospective investors in the Prestige Fund.

Dembski's False Promise to Regularly Monitor the Prestige Fund's Performance

40. The PPM disclosed that Stephan was Prestige's "Chief Investment Officer" and, as such, had "exclusive responsibility to make the Fund's investment decisions on behalf of the General Partner."

41. Dembski, however, understood that some of his long-term clients did not know Stephan well enough to entrust him with their money. Dembski, therefore, told certain clients that he would monitor the Prestige Fund regularly—to some, he even promised daily monitoring—to ensure that it remained a good investment; even going as far as to tell one investor that he would redeem her investment if the Prestige Fund lost any money. This statement was a comfort to investors because they had known and trusted Dembski (not Stephan) for many years. Additionally, Dembski even told at least one client that he did not need to concern himself with the PPM and to disregard the document.

42. Dembski's assurances were, however, false (or at least misleading). Dembski understood, even before the Prestige Fund was operational, that he planned to have no involvement with the Prestige Fund's trading or performance.

43. Dembski understood from his discussions with the Law Firm that while he could own part of Prestige, an unregistered investment adviser, he could not—because of his ownership position in Reliance Financial, a soon-to-be registered investment adviser—be involved in managing the Prestige Fund. In order to avoid the appearance of such management, therefore, Dembski did not—contrary to his promises to certain clients—even check on the Prestige Fund's performance or receive the Fund's quarterly performance statements with any regularity. Dembski was, at best, aware of the Prestige Fund's performance only from information provided by his own clients or from sporadic conversations with Stephan.

Dembski's Other False and Misleading Statements

44. Dembski made a number of other false and misleading statements to Reliance Financial clients designed to assure them that the Prestige Fund would employ a trading strategy that was sophisticated, safe, and/or in demand:

a. He told at least two advisory clients that large investment banks had expressed interest in either investing millions of dollars into the Prestige Fund or in outright purchasing the Algorithm;

b. He told another advisory client who invested in the Fund that he had met with attorneys in New York City about patenting the Algorithm in order to ensure that no one else could take his idea; and

c. He told an advisory client who invested in the Fund that the Prestige Fund was insured by the Federal Deposit Insurance Corporation.

45. None of these statements were true, as Dembski knew or recklessly disregarded. They were, however, important to his clients because they created the false appearance that other, more sophisticated, investors had vetted the Algorithm and that there was little risk to investing in the Prestige Fund.

46. In addition, Dembski created the false impression that he—and not Stephan—had created the Algorithm. This was false (or at least highly misleading) as Stephan had created the Algorithm and brought the idea to Dembski. Again, however, Dembski understood that his Reliance Financial clients did not know or have reason to trust Stephan's qualification to run an algorithmic trading platform. When talking to certain investors he, therefore, downplayed or wholly eradicated Stephan's involvement in the trading platform's creation in order to obtain investments from his own trusting advisory clients.

H. THE PRESTIGE FUND COLLAPSES

47. The Prestige Fund traded using the Algorithm approximately from April 2011 to September 2011. From that point on—because the Algorithm never worked as intended—Stephan stopped using it altogether. Instead, contrary to what investors were told the Prestige Fund's trading strategy would be, Stephan manually placed trades.

48. Grenda withdrew his clients' investments from the Prestige Fund in approximately October 2012. His investors suffered total collective losses of approximately $320,000, or about 4% of their total investments.

49. In December 2012, the Prestige Fund lost approximately 80% of its value as a result of Stephan manually investing and trading in stock options. Dembski's client's, therefore, lost the vast majority of their Prestige Fund investments.

50. In addition to the knowing or reckless conduct outlined above—by failing to tell their advisory clients the true nature about the Prestige Fund and by disseminating a PPM that falsely described Stephan's experience—Dembski and Grenda each also failed to act as a reasonably careful person would in similar circumstances.

I. GRENDA BORROWS MONEY FROM HIS ADVISORY CLIENTS

51. In addition to the above, Grenda also made false and misleading statements and omissions to two advisory clients—a mother and daughter ("Lenders")—in order to borrow approximately $175,000 money from them. In or about September 2009, Grenda asked to borrow $100,000 from the Lenders, telling them that he wanted the loan to grow his business. Trusting Grenda, the Lenders wired $100,000 to him on September 11, 2009 from the daughter's bank account.

52. Grenda did not use the money to grow his business, however. Rather, in the days immediately following the loan, Grenda used a large portion of the money—approximately 50%—to pay personal expenses and debts.

53. In or about December 2009, Grenda requested to borrow more money from the Lenders, again telling them that he wanted the loan to grow his business. Grenda also failed to tell the Lenders that he had used at least a substantial portion of the prior loan for personal expenses. On December 16, 2009, the Lenders wrote a check for an additional $75,000 to Grenda from the daughter's bank account.

54. Grenda again used a large portion of the money to pay personal expenses and debts. Grenda's statements to the Lenders that he intended to use the loans to build his business were, therefore, false and misleading as Grenda knew or recklessly disregarded. In or around February 2010, one of the Lenders visited Grenda at his business premises to inquire about the loan and he again told her that he planned to use the money to grow his business.

55. In addition, to his knowing or reckless conduct relating to the loans, by failing to tell his advisory clients the truth about his use of the loans—Grenda also failed to act as a reasonably careful person would in similar circumstances.

J. <u>VIOLATIONS</u>

56. As a result of the conduct described above, Respondents Reliance Financial, Dembski, and Grenda willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit, respectively, fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

57. As a result of the conduct described above, Respondents Reliance Financial, Dembski and Grenda willfully violated Sections 206(1) and (2) of the Advisers Act, which prohibit an investment adviser from, respectively, "employ[ing] any device, scheme, or artifice to defraud any client or prospective client," or "engag[ing] in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client."

58. As a result of the conduct described above, Respondents Dembski and Grenda willfully aided and abetted and caused:

a. Prestige's violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder;

b. Prestige's violations of Section 206(4) of the Advisers Act, which prohibits an investment adviser from "engag[ing] in any act, practice, or course of business which is fraudulent, deceptive, or manipulative," and Rule 206(4)-8 thereunder, which prohibits any investment adviser to a pooled investment vehicle from "mak[ing] any untrue statement of a material fact or omitting to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle," or "otherwise engag[ing] in any act, practice or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle"; and

c. Reliance Financial's violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Sections 206(1) and (2) the Advisers Act.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 8A of the Securities Act including, but not limited to, disgorgement and civil penalties;

C. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Sections 15(b) and 21C of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

D. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Sections 203(e), 203(f) and 203(k) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act;

E. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9 of the Investment Company Act; and

F. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act, and Section 203(k) of the Advisers Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, Section 206(1), (2), and (4) of the Advisers Act and Rule 206(4)-8 thereunder, whether Respondents should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act, Section 21B(a) of the Exchange Act, Section 203(i) of the Advisers Act, and Section 9(d) of the Investment Company Act, and whether Respondents should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, Section 203 of the Advisers Act, and Section 9 of the Investment Company Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73806 / December 10, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16313

In the Matter of The Billiard Channel, Inc., Boston Chicken, Inc., Bridgeport Capital Corp., and Broadway International Development Corp., Respondents.	ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS AND NOTICE OF HEARING PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934

I.

The Securities and Exchange Commission ("Commission") deems it necessary and appropriate for the protection of investors that public administrative proceedings be, and hereby are, instituted pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") against Respondents The Billiard Channel, Inc., Boston Chicken, Inc., Bridgeport Capital Corp., and Broadway International Development Corp.

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. The Billiard Channel, Inc. (CIK No. 1091495) is a Delaware corporation located in Langley, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). The Billiard Channel is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on September 13, 1999, which reported a net loss of $6,186 from the company's September 18, 1998 inception to April 22, 1999.

2. Boston Chicken, Inc. (CIK No. 894751) is a Delaware corporation located in Golden, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Boston Chicken is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-Q for the period ended October 4, 1998, which reported a net loss of over $725 million for the prior nine months.

3. Bridgeport Capital Corp. (CIK No. 1140770) is a delinquent Colorado corporation located in Boulder, Colorado with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Bridgeport is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-QSB for the period ended September 30, 2002, which reported a net loss of $650 for the prior three months.

4. Broadway International Development Corp. (CIK No. 1219041) is a permanently revoked Nevada corporation located in Vancouver, British Columbia, Canada with a class of securities registered with the Commission pursuant to Exchange Act Section 12(g). Broadway International is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10 registration statement on September 23, 2003, which reported a net loss of $277,187 from the company's July 31, 2001 inception to December 31, 2002.

B. DELINQUENT PERIODIC FILINGS

5. As discussed in more detail above, all of the Respondents are delinquent in their periodic filings with the Commission, have repeatedly failed to meet their obligations to file timely periodic reports, and failed to heed delinquency letters sent to them by the Division of Corporation Finance requesting compliance with their periodic filing obligations or, through their failure to maintain a valid address on file with the Commission as required by Commission rules, did not receive such letters.

6. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

7. As a result of the foregoing, Respondents failed to comply with Exchange Act Section 13(a) and Rules 13a-1 and/or 13a-13 thereunder.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate for the protection of investors that public administrative proceedings be instituted to determine:

A. Whether the allegations contained in Section II hereof are true and, in connection therewith, to afford the Respondents an opportunity to establish any defenses to such allegations; and,

B. Whether it is necessary and appropriate for the protection of investors to suspend for a period not exceeding twelve months, or revoke the registration of each class of securities registered pursuant to Section 12 of the Exchange Act of the Respondents identified in Section II hereof, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents.

IV.

IT IS HEREBY ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice [17 C.F.R. § 201.110].

IT IS HEREBY FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within ten (10) days after service of this Order, as provided by Rule 220(b) of the Commission's Rules of Practice [17 C.F.R. § 201.220(b)].

If Respondents fail to file the directed Answers, or fail to appear at a hearing after being duly notified, the Respondents, and any successor under Exchange Act Rules 12b-2 or 12g-3, and any new corporate names of any Respondents, may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f), and 310 of the Commission's Rules of Practice [17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f), and 201.310].

This Order shall be served forthwith upon Respondents personally or by certified, registered, or Express Mail, or by other means permitted by the Commission Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 120 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice [17 C.F.R. § 201.360(a)(2)].

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9687 / December 10, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73803 / December 10, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3977 / December 10, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31368 / December 10, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16312

In the Matter of **SCOTT M. STEPHAN,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, SECTIONS 203(f) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), Sections 203(f) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Scott M. Stephan ("Respondent" or "Stephan").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Sections 15(b) and 21C of the Securities Exchange Act of 1934, Sections 203(f) and 203(k) of the Investment Advisers Act of 1940, and Section 9(b) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order and Notice of Hearing ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

A. SUMMARY

1. This case involves misconduct by Scott M. Stephan, joint owner of Prestige Wealth Management, LLC ("Prestige" or "General Partner"), an unregistered investment adviser to a hedge fund called Prestige Wealth Management Fund, LP ("Prestige Fund" or the "Fund"). Stephan made false and misleading statements in connection with the Prestige Fund, for which Stephan was the portfolio manager.

2. In 2007, Stephan began working for his longtime friend, Timothy S. Dembski ("Dembski"), and Dembski's business partner, Walter F. Grenda, Jr. ("Grenda"). At the time, Dembski and Grenda jointly owned Reliance Financial Group ("Reliance Group"), which was a then-Buffalo, New York based unregistered investment adviser. As joint owners of Reliance Group, Dembski and Grenda made investment recommendations to clients they had in the Buffalo area.

3. Prior to working for Dembski and Grenda, Stephan had no professional experience trading securities, making investment decisions, or managing investment portfolios. Dembski and Grenda initially hired Stephan primarily to help the two market Reliance Group's investment advisory services to prospective clients.

4. Starting in late 2010, Dembski and Grenda undertook efforts to form a registered investment adviser entity. On January 21, 2011, Reliance Financial Advisors, LLC ("Reliance Financial") became registered with the Commission as an investment adviser. At all relevant times, Dembski and Grenda jointly owned Reliance Financial.

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

5. Around the same time in 2010 and 2011, Stephan, along with Dembski, founded Prestige and the Prestige Fund. The Prestige Fund's trading strategy was described to prospective investors as being fully-automated with all trades being made according to, and by, a computer algorithm (the "Algorithm"). Stephan created the Algorithm.

6. Dembski and Grenda, often with Stephan's assistance, marketed the Prestige Fund to potential investors. Dembski and Grenda sold interests in the Prestige Fund exclusively to long-standing clients of their investment advisory services at Reliance Group and Reliance Financial—and with respect to Dembski, also to clients of his for whom he prepared their tax returns and filings. As Dembski and Grenda understood from advising these advisory and tax clients over the years, most of them were retired or near retirement, on fixed incomes, and lacked investment acumen.

7. As Stephan knew or recklessly disregarded, the Prestige Fund was a highly speculative, risky investment. Also, neither Stephan nor Dembski had any experience in managing a hedge fund and, Stephan had virtually no investing experience at all.

8. Nonetheless, Stephan knowingly or recklessly made false and misleading statements to Dembski's and Grenda's advisory clients (and others) in order to create the false appearance that an investment in the Prestige Fund was less risky than it was. Stephan:

a. Drafted a biography for the Prestige Fund's private placement memorandum ("PPM") that misrepresented his experience in the securities industry; and

b. Deceptively failed to inform investors that he turned off the Algorithm in the Prestige Fund and instead began to make investment decisions himself and manually placing trades in contravention to representations made about the Prestige Fund's automated trading strategy.

9. Ultimately Dembski's clients (19 of them) invested approximately $4 million collectively in the Prestige Fund and Grenda's clients (23 of them) invested approximately $8 million collectively in the Prestige Fund. The Prestige Fund started trading in April 2011.

10. In December 2012, the Prestige Fund collapsed, losing approximately 80% of its value. The Prestige Fund collapsed as a direct result of Stephan placing manual trades in direct contravention to the automated trading strategy sold to investors.

B. <u>RESPONDENT</u>

11. **Scott M. Stephan**, age 40, resides in Hamburg, New York. Stephan co-founded the Prestige Fund and its General Partner, Prestige, in early 2011 and was the Fund's Chief Investment Officer and sole portfolio manager. Prior to founding the Prestige Fund, Stephan worked at the Reliance Group. In addition, from approximately June 2009 through March 2011, Stephan was a registered representative associated with a registered broker-dealer ("BD1").

C. OTHER RELEVANT PEOPLE AND ENTITIES

12. **Timothy S. Dembski**, age 42, resides in Lancaster, New York. In January 2011, Dembski co-founded and was Managing Partner at Reliance Financial, an investment adviser registered with the Commission. Also in early 2011, Dembski co-founded the Prestige Fund and its General Partner, Prestige. Prior to founding Reliance Financial and the Prestige Fund, Dembski provided investment advisory services to individual clients in his role at Reliance Group. In addition, from approximately October 2006 through March 2011, Dembski was a registered representative associated with BD1. From approximately September 2011 to July 2013, Dembski was a registered representative with another registered broker-dealer ("BD2").

13. **Walter F. Grenda, Jr.**, age 57, resides in Buffalo, New York. In January 2011, Grenda co-founded and was Managing Partner at Reliance Financial, an investment adviser registered with the Commission. Prior to founding Reliance Financial, Grenda provided investment advisory services to individual clients in his role at Reliance Group. In addition, Grenda was a registered representative with BD1 from approximately October 2006 through March 2011 and with BD2 from approximately September 2011 through July 2013.

14. **Prestige Wealth Management Fund, LP**, was a private investment fund under the Investment Company Act and organized as a limited partnership under Delaware law on November 19, 2010.

15. **Prestige Wealth Management, LLC**, was a limited liability company organized in Delaware on November 12, 2010, and adviser to the Prestige Fund. Dembski and Stephan were the sole members of Prestige (which served as the General Partner to the Prestige Fund), each owning 50%. Prestige charged the Prestige Fund a 2% management fee and a 20% performance fee on an annualized basis. Prestige was not registered with the Commission.

16. **Reliance Financial Advisors, LLC** is was a Buffalo-based investment adviser that registered with the Commission in January 2011. Dembski and Grenda founded and, at all relevant times, jointly owned Reliance Financial.

17. **Reliance Financial Group**, was a Buffalo-based investment adviser founded and jointly owned by Dembski and Grenda from 1998 to 2011. Reliance Group was not registered with the Commission. Dembski and Grenda transferred their advisory clients from Reliance Group to Reliance Financial starting in approximately February 2011.

FACTS

D. DEMBSKI HIRES STEPHAN TO WORK AT RELIANCE GROUP

18. Dembski and Stephan were long-time friends, having known each other since approximately the late 1990s. In approximately April 2007, Dembski hired Stephan to work for him and Grenda at Reliance Group. When Stephan first started working for Dembski and Grenda, he had no professional experience in the securities industry, trading securities, investing, or

providing investment advice to others. Virtually all of Stephan's professional experience to that point had been collecting on—and managing others who collected on—past-due car loans.

19. Dembski and Grenda hired Stephan to assist them with telemarketing efforts for the services they offered at Reliance Group. In that role, Stephan tried to locate new investment advisory clients for Dembski and Grenda through, among other things, placing cold calls and arranging sales seminars.

20. At no point, however, did Stephan provide Reliance Group's clients with investment advice, trade any securities, or make any investment decisions. At most, Stephan—from time to time—discussed investment ideas with Reliance Group's college interns and assisted Grenda with various research tasks.

E. <u>DEMBSKI AND STEPHAN SET UP THE PRESTIGE FUND</u>

21. In Summer 2010, Stephan approached Dembski about establishing a hedge fund to undertake an automated trading strategy of Stephan's own design, the Algorithm. The Algorithm purportedly had the following features:

a. It operated as a day-trading strategy that would hold no securities overnight;

b. It was designed to automatically buy or sell stocks and interests in Exchange Traded Funds ("ETFs") at pre-programmed times of the day and according to pre-programmed market signals; and

c. It was supposed to automatically enter a long position on a chosen stock or ETF should it go up approximately 1 to 1.5 percent and it would automatically enter a short position on a chosen stock or ETF should it go down approximately 1 to 1.5 percent. Once in a position, the Algorithm automatically would exit it after a 3 percent gain or a 1 percent loss, respectively.

22. Stephan and Dembski did not undertake any real-time testing of the Algorithm, for example, by investing funds using its formula to see how it performed under actual market conditions. At most, they "back tested" the Algorithm, *i.e.*, looked at certain securities trading in the past to see how the Algorithm would have performed had it actually placed trades in those securities over those periods.

23. Neither Stephan nor Dembski had any experience establishing or running a hedge fund or in algorithmic or other automated trading strategies. Indeed, as discussed, Stephan had no experience managing client funds. Nonetheless, Stephan and Dembski decided to set up the Prestige Fund to trade based on the Algorithm.

24. Stephan and Dembski retained a law firm (the "Law Firm") to advise them on the process of setting up a hedge fund and to assist in preparing the necessary fund documents, including the PPM, limited partner agreements, and subscription agreements.

25. The Law Firm advised Dembski that—because of his role with Reliance Financial, a registered investment adviser—they would need to register Prestige with the Commission unless Dembski avoided having anything to do with the day-to-day management of the Prestige Fund. Dembski and Stephan agreed that Dembski would have no day-to-day involvement in the Fund.

26. In or about November 2010, Stephan and Dembski established Prestige and the Prestige Fund (the former of which served as General Partner and adviser to the Fund). While Dembski and Stephan were each 50 percent owners of the General Partner, they agreed that Dembski would receive a greater portion (two-thirds) of the performance and management fees, at least initially.

F. STEPHAN HELPS RECOMMEND AND SELL INVESTMENTS IN THE PRESTIGE FUND

27. From about February 2011 to September 2012, Dembski, and Grenda, with Stephan's assistance, raised approximately $12 million selling interests in the Prestige Fund. The Prestige Fund's investors were comprised of Dembski's and Grenda's advisory clients at Reliance Financial and its predecessor entity (Reliance Group), as well as Dembski's tax preparation clients. Ultimately, Dembski procured approximately $4 million in investments for the Prestige Fund from approximately 19 of his advisory or tax clients, while Grenda procured approximately $8 million in investments from approximately 23 of his advisory clients.

G. STEPHAN MAKES AND DISTRIBUTES MATERIALLY FALSE AND MISLEADING STATEMENTS IN RECOMMENDING AND SELLING INVESTMENTS IN THE PRESTIGE FUND

28. In establishing the Prestige Fund, Stephan understood: (a) that the Fund was a speculative investment; and (b) that he, the Algorithm's creator, had no prior experience running an algorithmic trading platform or hedge fund and, indeed, had virtually no experience trading or investing at all. Indeed, Stephan's only trading experience was investing approximately $1,000 that his father loaned to him in or around 2006 or 2007, which Stephan lost.

29. Stephan made, or disseminated, to investors in the Prestige Fund, a number of materially false and misleading statements in order to create the appearance that the Prestige Fund was a relatively safe, in-demand investment, overseen by professional money managers, including by himself and Dembski (the investment advisor or tax preparer who many of the potential investors had known and trusted for years).

Stephan's Biography

30. Prestige's PPM, dated February 1, 2011, contained the following biography for Stephan:

> Scott M. Stephan is co-founder and Chief Investment Officer of the General Partner. He has exclusive responsibility to make the Fund's investment decisions on behalf of the General Partner. Mr. Stephan has worked in the financial services industry for over 14 years. The first half of his career he co-managed a portfolio of over $500 million for First Investors Financial Services. Afterwards, Mr. Stephan took a position as Vice President of Investments for a New York based investment company in which he was responsible for portfolio management and analysis.

31. The PPM's description of Stephan's professional experiences prior to joining Reliance Group as well as his being "responsible for portfolio management and analysis" at Reliance Group were highly misleading, if not outright false. *First*, as discussed above, Stephan had no experience in the securities industry prior to joining Reliance Group in 2007. From 1999 to 2007, Stephan was responsible for collecting, or managing a group that collected, on past due car loans. This involved managing a group within a debt-collection call center, reaching out to debtors to obtain payment, and recommending cars to be repossessed in the event of non-payment. In that position, Stephan undertook no trading, managed no securities portfolios, provided no investment advice, and made no decisions concerning securities investments. Moreover, Stephan had no responsibility for determining what car loans to purchase and the value of the loans he was responsible for collecting was far less than $500 million.

32. *Second*, upon joining Reliance Group, Stephan had little-to-no experience selecting or making investments. Indeed, Dembski and Grenda hired him to undertake telemarketing efforts. Stephan received his securities Series 7, 63 and 66 licenses only in 2009 and, even then, advised no clients of his own, undertook no trading, and had no say over the portfolios of the Reliance Group's clients.

33. Stephan drafted his own professional biography and knew or recklessly disregarded that the biography was false or misleading. Stephan knew that he had no prior experience in the securities industry, that he received his securities licenses only in 2009, and that, even at Reliance Group, he had minimal (if any) involvement managing assets, trading securities, or providing investment advice to clients.

H. THE PRESTIGE FUND COLLAPSES

34. The Prestige Fund traded using the Algorithm approximately from April 2011 to in or around September 2011. From that point on—because the Algorithm never worked as intended—Stephan stopped using it altogether. Instead, contrary to what investors were told the Prestige Fund's trading strategy would be, Stephan manually placed trades. Stephan knew, or recklessly disregarded, that Prestige Fund investors had been told that the Fund's trading strategy

would be fully automated and undertaken entirely by the Algorithm. He also knew or recklessly disregarded that his manual trading was entirely inconsistent with this stated strategy.

35. In December 2012, the Prestige Fund lost approximately 80% of its value as a result of Stephan manually investing and trading in stock options.

I. VIOLATIONS

36. As a result of the conduct described above, Respondent Stephan willfully violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit, respectively, fraudulent conduct in the offer or sale of securities and in connection with the purchase or sale of securities.

37. As a result of the conduct described above, Respondent Stephan willfully violated Section 206(4) of the Advisers Act, which prohibits an investment adviser from "engag[ing] in any act, practice, or course of business which is fraudulent, deceptive, or manipulative," and Rule 206(4)-8 thereunder, which prohibits any investment adviser to a pooled investment vehicle from "mak[ing] any untrue statement of a material fact or omitting to state a material fact necessary to make the statements made, in the light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle," or "otherwise engag[ing] in any act, practice or course of business that is fraudulent, deceptive, or manipulative with respect to any investor or prospective investor in the pooled investment vehicle."

38. As a result of the conduct described above, Respondent Stephan willfully aided and abetted and caused Prestige's violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder.

IV.

Pursuant to this Order, Respondent agrees to additional proceedings in this proceeding to determine what, if any, disgorgement and civil penalties are appropriate under the Securities Act, Exchange Act, Advisers Act and Investment Company Act. In connection with such additional proceedings: (a) Respondent agrees that he will be precluded from arguing that he did not violate the federal securities laws described in this Order; (b) Respondent agrees that he may not challenge the validity of this Order; (c) solely for the purposes of such additional proceedings, the allegations of this Order shall be accepted as and deemed true by the hearing officer; and (d) the hearing officer may determine the issues raised in the additional proceedings on the basis of affidavits, declarations, excerpts of sworn deposition or investigative testimony, and documentary evidence.

V.

In view of the foregoing, the Commission deems it appropriate in the public interest and for the protection of investors to impose the sanctions agreed to in the Offer, and to institute proceedings to determine what, if any, disgorgement and civil penalties are appropriate under the Securities Act, Exchange Act, Advisers Act and Investment Company Act.

Accordingly, pursuant to Section 8A of the Securities Act, Sections 15(b) and 21C of the Exchange Act, Sections 203(f) and 203(k) of the Advisers Act, and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, and Section 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder.

B. Respondent be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

VI.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section V hereof shall be convened at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

If Respondent fails to appear at a hearing after being duly notified, Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commissions' Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice, 17 C.F.R. § 201.360(a)(2).

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73825 / December 11, 2014

Admin. Proc. File No. 3-15824

In the Matter of the Application of

STEVEN ROBERT TOMLINSON

For Review of Disciplinary Action Taken By
FINRA

OPINION OF THE COMMISSION

REGISTERED SECURITIES ASSOCIATION—REVIEW OF DISCIPLINARY PROCEEDINGS

Conduct Inconsistent with Just and Equitable Principles of Trade

Registered securities association found that registered representative of member firm engaged in conduct inconsistent with just and equitable principles of trade when he downloaded confidential nonpublic information about more than 2,000 customers from his former firm's computer system onto a personal flash drive without the customers' consent and then shared that confidential information with his new firm. *Held*, association's findings of violation and sanction imposed are *sustained*.

APPEARANCES:

Steven Robert Tomlinson, pro se.

Alan Lawhead, *Michael J. Garawski*, and *Celia L. Passaro*, for the Financial Industry Regulatory Authority, Inc.

Appeal filed: April 4, 2014
Last brief received: July 18, 2014

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Steven Robert Tomlinson, a registered representative with Wells Fargo Advisors, LLC ("Wells Fargo"), appeals from FINRA disciplinary action.[1] FINRA found that Tomlinson violated NASD Conduct Rule 2110 when he downloaded confidential nonpublic information concerning more than 2,000 customers from his former broker-dealer employer's computer system without authorization and then shared that information with Wells Fargo personnel.[2] FINRA suspended him for ninety days in all capacities. We base our findings on an independent review of the record.

I. Background

A. Tomlinson was associated with RJFS and subject to RJFS's privacy policies.

The facts are largely undisputed. Tomlinson entered the securities industry in 1981. In 2001, Tomlinson joined Corning Credit Union (the "Credit Union") as a financial advisor in its investment services group, and he later became a manager of the group.[3] Between June 2005 and November 2008, the Credit Union, which was not a FINRA member, was affiliated with Raymond James Financial Services, Inc. ("RJFS"), a FINRA member, and offered securities through RJFS. Tomlinson was dually employed by the Credit Union and RJFS and was registered with RJFS as a general securities representative, an investment company products/variable contracts limited representative, and a general securities sales supervisor. Tomlinson also served as a branch manager at RJFS.

As an "associate" affiliated with RJFS, Tomlinson was subject to RJFS's Compliance Manual (the "Manual"), dated July 2008, which set forth guidance to employees in handling confidential customer information.[4] The Manual provided, in relevant part, that:

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1 We apply the conduct rules of NASD, FINRA's predecessor, because those were the rules in place at the time of the misconduct. *See Kent M. Houston*, Securities Exchange Act Release No. 66014, 2011 WL 6392264, at *1 n.2 (Dec. 20, 2011); *John B. Busacca, III*, Exchange Act Release No. 63312, 2010 WL 5092726, at *1 n.2 (Nov. 12, 2010), *petition denied*, 449 Fed. App'x 886 (11th Cir. 2011).

2 NASD Conduct Rule 2110, now FINRA Rule 2010, states that "a member, in the conduct of its business, shall observe high standards of commercial honor and just and equitable principles of trade." Rule 2110 applies to Tomlinson through NASD General Rule 115 (now FINRA Rule 140), which provides that persons associated with a member have the same duties and obligations as a member.

3 As a precondition to his employment, Tomlinson signed a Covenant Not to Compete in which he agreed that, in the event that he left his employment at the Credit Union, he would not solicit customers that he did not bring with him when he joined the Credit Union.

4 According to the Manual, "associates" included branch managers, financial advisors, registered sales assistants, professional partners, non-registered support staff, and RJFS home

(continued...)

Associates . . . are responsible for protecting information used in company business from unauthorized access unless expressly approved for public disclosure or client use. Associates may not share customer information with third parties unless specifically authorized by the client. Customer and confidential information may not be removed from a Raymond James office without the branch manager's permission.

It is not acceptable for associates . . . to e-mail, or otherwise transmit, non-public or personally identifiable information . . . to a third-party for any reason other than a bona fide business purpose with the client's consent. Additionally, if such data needs to be transmitted electronically, the RJFS sender has the obligation to ensure the communication is encrypted or password protected . . . .

* * *

Raymond James requires that all non-public, personally identifiable information or any other information related to Raymond James business on any computer or laptop hard drive be erased before disposal or donation (this is called wiping a hard drive).

* * *

The firm views the protection of confidential information as an important issue. . . . It is the responsibility of all financial advisors who disassociates [sic] with RJFS to ensure that they have obtained prior consent from each client prior to maintaining any client's personally identifiable information. [5]

The Manual also contained provisions that gave branch managers like Tomlinson heightened responsibilities regarding RJFS's data security policies. In particular, the Manual required branch managers to ensure that financial advisors under their supervision comply with RJFS policies and adequately safeguard customers' confidential information. Tomlinson testified that he was familiar with the Manual, understood his responsibilities set forth in the Manual, and was obligated to abide by the Manual's requirements.

(...continued)
office personnel. Given his position as branch manager, Tomlinson was an "associate" affiliated with RJFS. The employment agreement that Tomlinson signed with RJFS and the Credit Union contained similar confidentiality provisions.

5 The Manual defined "personally identifiable information" to include Social Security numbers, account numbers, net worth, income, tax bracket, and other nonpublic information unique to an individual or entity.

B. Tomlinson decided to leave RJFS and the Credit Union and join Wells Fargo.

In mid-2008, Tomlinson began exploring the possibility of becoming a branch manager at Wells Fargo in its Painted Post, New York, office. Tomlinson received a salary from RJFS and the Credit Union but no commissions. Wells Fargo offered him an opportunity to earn commissions and develop a book of business.

In October 2008, after attending a Wells Fargo recruiting meeting, Tomlinson decided to leave RJFS and the Credit Union and join Wells Fargo. In contemplation of his joining the firm, a Wells Fargo recruiter specifically instructed him about the types of customer information that he could and could not take with him when he left RJFS and the Credit Union.[6] The recruiter told him that, because RJFS was not a signatory to "The Protocol for Broker Recruiting" (the "Protocol"), the only information that he could take with him was in the nature of a "Christmas card list" consisting of customer names, addresses, and telephone numbers.[7] The recruiter gave Tomlinson a Wells Fargo flash drive to use in downloading this information.

C. Tomlinson downloaded onto his personal flash drive and personal laptop confidential nonpublic information relating to more than 2,000 Credit Union customers.

Before resigning from RJFS and the Credit Union, Tomlinson downloaded onto his personal flash drive, which was not encrypted or password-protected, and personal laptop confidential nonpublic information concerning more than 2,000 RJFS and Credit Union customers.[8] He downloaded the information from RJFS's and the Credit Union's computer systems and from third-party websites over the course of several days and nights. The information included customers' names, addresses, account numbers and balances, quarterly account statements, Social Security numbers, and birth dates. Tomlinson testified that he took this information so that he could contact his customers about his move and assist them if they transferred their accounts to Wells Fargo. Tomlinson admitted, however, that he did not need most of the information that he downloaded for this purpose. Approximately 160 of the affected

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6 The Wells Fargo recruiter also provided Tomlinson with a "Financial Advisor Integration Planner," which memorialized these instructions.

7 The Protocol is an agreement voluntarily entered into by over 400 brokerage firms, and is administered by the Securities Industry and Financial Markets Association. Firms that are signatories to the Protocol agree not to sue one another if registered representatives moving from one Protocol firm to another take with them client names, addresses, telephone numbers, e-mail addresses, and account title information, but no other documents or information. *See generally Dante J. DiFrancesco*, Exchange Act Release No. 66113, 2012 WL 32128, at *7 & nn.47-48 (Jan. 6, 2012).

8 Tomlinson testified that he could not get the Wells Fargo flash drive to work properly so he decided to use his personal flash drive instead.

customers were customers assigned to Tomlinson; the rest were customers assigned to other financial advisors at the Credit Union.[9] Tomlinson did not tell anyone at either RJFS or the Credit Union that he had downloaded customers' confidential nonpublic information to take with him to Wells Fargo; nor did he tell any RJFS or Credit Union customers or seek their permission to download and remove that information. He also did not tell anyone at Wells Fargo what he had done.

D. Tomlinson gave the flash drive to Wells Fargo personnel.

On November 24, 2008, Tomlinson resigned from RJFS and the Credit Union. During his exit interview, he returned his keys, badge, and other items belonging to the Credit Union. He also met with an Information Technology ("IT") employee who "wiped clean" his cell phone of all information related to the Credit Union and then returned the phone to him with only his personal information on it. Tomlinson did not mention to the IT employee or anyone else at the Credit Union that he had a substantial amount of confidential customer information saved on his personal flash drive and personal laptop.[10]

Tomlinson left the Credit Union shortly before 6:00 p.m. that day and went to his new Wells Fargo office. He met with a Wells Fargo administrative assistant who had been assigned to help him prepare announcements of his move. He gave the assistant his personal flash drive but, because it was late in the day and had started to snow, they agreed to wait until the next day to work on the announcements. He allowed the assistant to keep the flash drive in her possession overnight without informing her that it contained confidential nonpublic information and was not encrypted or password-protected.

On November 25, 2008, the Wells Fargo assistant used the information on the flash drive to create mailing labels for Tomlinson's announcements. She worked on a computer at the front reception desk where a receptionist was also working. Tomlinson did not supervise the assistant's work. At some point, the assistant had difficulty accessing the information on the flash drive and called IT personnel. She gave IT personnel permission to access remotely the computer to help her. The assistant eventually was able to create mailing labels and returned the

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9 The Credit Union encouraged its financial advisors to service customer accounts regardless of whether the customer was assigned to the particular advisor. Tomlinson sometimes reassigned customers, including his own, to other advisors depending on their workloads. Tomlinson acknowledged that he had no previous business relationship with most of the customers that he had assigned to other advisors.

10 The Credit Union's chief information officer ("CIO") testified that the Credit Union would not have known to ask about these personal devices because it was against policy for employees to save Credit Union data to a personal device, including a personal flash drive or personal laptop. According to the CIO, had Tomlinson used a company flash drive or laptop, as he was required to do, an IT employee would have taken back those devices when Tomlinson resigned.

flash drive to Tomlinson that afternoon. Wells Fargo sent Tomlinson's announcements to his 160 RJFS and Credit Union customers.

E. The Credit Union discovered Tomlinson's misconduct.

The Credit Union began investigating whether Tomlinson had violated his non-compete agreement after a customer reported receiving a mailing from him.[11] During the investigation, the Credit Union's CIO examined Tomlinson's desktop computer and discovered that Tomlinson had downloaded customer information onto a flash drive shortly before he resigned. The CIO also learned that some customer information had been placed into a directory that Tomlinson had labeled to denote a connection to Wells Fargo. The CIO requested that Wells Fargo check its computers for files that Tomlinson had taken from RJFS and the Credit Union. After checking, Wells Fargo informed the CIO that it had found one of Tomlinson's files on a secretary's computer.

On December 1, 2008, the Credit Union delivered a letter to Tomlinson demanding that he return the flash drive containing the confidential nonpublic information and destroy all other versions of the information in his possession. Tomlinson testified that he found the letter to be "scary" and panicked. He began deleting all of the files that he had downloaded onto the flash drive with the exception of one file containing data related solely to his own customers. He also deleted Credit Union files from his personal laptop. He stopped deleting files only after a Wells Fargo attorney told him to stop. Wells Fargo turned over to the Credit Union Tomlinson's personal flash drive, personal laptop, and cell phone. The Credit Union CIO reviewed those devices and determined that Tomlinson had downloaded and taken confidential nonpublic information concerning more than 2,000 RJFS and Credit Union customers.

F. FINRA Proceedings

In December 2011, FINRA's Department of Enforcement ("Enforcement") brought a complaint alleging that Tomlinson engaged in unethical conduct, in violation of NASD Conduct Rule 2110, by downloading confidential customer information protected as "nonpublic personal information" under Regulation S-P,[12] without authorization, and disclosing that information to

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[11] *See supra* note 3.

[12] 17 C.F.R. Part 248, Subpart A. We adopted Regulation S-P pursuant to the financial privacy provisions of the Gramm-Leach Bliley Act ("GLBA"), Pub. L. No. 106-102, 113 Stat. 1338 (1999). The regulation generally prohibits broker-dealers from disclosing "nonpublic personal information" about their customers to nonaffiliated third parties unless they provide their customers with proper notice and a reasonable opportunity to opt out of the disclosure before it is made. 17 C.F.R. § 248.10(a)(1). "Nonpublic personal information means: (i) Personally identifiable financial information; and (ii) Any list, description, or other grouping of consumers . . . that is derived using any personally identifiable financial information that is not publicly available information." *Id.* § 248.3 (t)(1)(i)-(ii). "Personally identifiable financial information . . . means any information: (i) A consumer provides to you [a broker-dealer] to

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Wells Fargo. A FINRA Hearing Panel conducted a hearing at which Tomlinson, the Credit Union CIO, the Wells Fargo administrative assistant, the Wells Fargo recruiter, and a FINRA staff member testified. Enforcement introduced into evidence a detailed timeline of Tomlinson's computer activity, which was admitted without objection. Following the hearing, the Panel found that Tomlinson had violated Rule 2110, as alleged in the complaint, and imposed a $10,000 fine and ten business-day suspension in all capacities. It also ordered him to pay costs.

Tomlinson appealed the Panel's findings of violation and sanctions, and Enforcement cross-appealed the Panel's sanctions, to FINRA's National Adjudicatory Council ("NAC"). In March 2014, the NAC issued its decision, affirming the Panel's finding of a Rule 2110 violation and increasing the suspension to ninety days in all capacities.[13] The NAC identified various factors as justifying its decision to increase the suspension, including that Tomlinson was a supervisor and should have known that he could not take and disclose confidential customer information when moving between firms. The NAC affirmed the $10,000 fine but declined to impose it or order that Tomlinson pay costs based on his demonstrated bona fide inability to pay. This application for review followed.

II. Analysis

A. Standard of Review

We base our findings on an independent review of the record and apply the preponderance of the evidence standard for self-regulatory organization disciplinary actions.[14] Pursuant to Exchange Act Section 19(e)(1), in reviewing an SRO disciplinary sanction, we determine whether the aggrieved person engaged in the conduct found by the SRO, whether such

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obtain a financial product or service from you; (ii) About a consumer resulting from any transaction involving a financial product or service between you and a consumer; or (iii) You otherwise obtain about a consumer in connection with providing a financial product or service to that consumer." *Id.* § 248.3(u)(1)(i)-(iii). Whether a broker-dealer's disclosure violates Regulation S-P typically will depend on the particular facts and circumstances surrounding the isclosure.

13 "[T]he NAC reviews the Hearing Panel's decision *de novo* and has broad discretion to modify the Hearing Panel's decisions and sanctions." *Harry Friedman*, Exchange Act Release No. 64486, 2011 WL 1825025, at *7 & n.22 (citing authority) (May 3, 2011). On appeal from a Hearing Panel decision, the NAC "may affirm, modify, reverse, increase, or reduce any sanction, or impose any other fitting sanction." *Id.* & n.23.

14 *See David M. Levine*, Exchange Act Release No. 48760, 2003 WL 22570694, at *9 n.42 (Nov. 7, 2003).

conduct violates the SRO's rules, and whether the SRO's rules are, and were applied in a manner, consistent with the purposes of the Exchange Act.[15]

B. Tomlinson violated NASD Conduct Rule 2110.

NASD Conduct Rule 2110 requires a member, "in the conduct of its business," to adhere to "high standards of commercial honor and just and equitable principles of trade."[16] Rule 2110 "state[s] 'broad ethical principles' and center[s] on the 'ethical implications' of . . . conduct."[17] The requirement that members adhere to just and equitable principles of trade serves as "'an industry backstop for the representation, inherent in the relationship between a securities professional and a customer, that the customer will be dealt with fairly and in accordance with the standards of the profession.'"[18] The requirement "set[s] forth a standard intended to encompass 'a wide variety of conduct that may operate as an injustice to investors or other participants in the marketplace.'"[19] As a result, Rule 2110 focuses on the conduct itself instead of the securities professional's intent or state of mind.[20] Thus, conduct alone, without scienter or bad faith, "can be sufficient to establish liability."[21]

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15 15 U.S.C. § 78s(e)(1). NASD Conduct Rule 2110 directly implements a mandate of Exchange Act Section 15A(b)(6), which requires, among other things, that FINRA design its rules to "promote just and equitable principles of trade." 15 U.S.C. § 78o-3(b)(6). As we have stated, "[t]his general ethical standard . . . is broader and provides more flexibility than prescriptive regulations and legal requirements. NASD Rule 2110 protects investors and the securities industry from dishonest practices that are unfair to investors or hinder the functioning of a free and open market, even though those practices may not be illegal or violate a specific rule or regulation. NASD Rule 2110 has proven effective through nearly 70 years of regulatory experience." *Notice of Filing of a Proposed Rule Change*, Exchange Act Release No. 58095, 2008 WL 2971979, at *2 (July 3, 2008), *Rule Change Approved Without Modification*, 2008 WL 4468749 (Sept. 25, 2008). We therefore find that Rule 2110 is consistent with the purposes of the Exchange Act.

16 NASD Conduct Rule 2110; *see supra* note 2.

17 *DiFrancesco*, 2012 WL 32128, at *5 (quoting *Thomas W. Heath, III*, Exchange Act Release No. 59223, 2009 WL 56755, at *4 (Jan. 9, 2009), *aff'd*, 586 F.3d 122 (2d Cir. 2009)).

18 *Id.* (quoting *Heath*, 2009 WL 56755, at *4).

19 *Id.* (quoting *Heath*, 2009 WL 56755, at *5).

20 *Id.*

21 *Id.*; *see also, e.g.*, *Keith Springer*, Exchange Act Release No. 45439, 55 SEC 632, 2002 WL 220611, at *7 (Feb. 13, 2002) (finding a violation of just and equitable principles of trade

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Applying Rule 2110, we find that Tomlinson's actions arose "in the conduct of [his] business" and were inconsistent with "high standards of commercial honor and just and equitable principles of trade."[22] FINRA has broad disciplinary authority under Rule 2110 that encompasses "business-related conduct that is inconsistent with just and equitable principles of trade, even if that activity does not involve a security."[23] An associated person's "business" includes his business relationship with his employers and his commercial relationships with his customers.[24] Tomlinson's "business" involved his relationship with RJFS and the Credit Union because his work for them was the reason that he had access to customers' confidential nonpublic information. His "business" also involved his commercial relationships with RJFS and Credit Union customers because he took their confidential nonpublic information for the purpose of transferring their accounts to Wells Fargo. Tomlinson does not dispute that his conduct was business-related.

In determining whether a securities professional's conduct is inconsistent with just and equitable principles of trade, we look to whether the conduct implicates a generally recognized duty owed to either customers or the firm.[25] Tomlinson's conduct implicated the duty, "grounded in fundamental fiduciary principles," to maintain the confidentiality of customers' nonpublic information.[26] Tomlinson breached this duty when he took customers' confidential nonpublic information from RJFS's and the Credit Union's computer systems without authorization and provided that information to the Wells Fargo assistant (who, in turn, gave IT employees access to

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based on improper post-execution allocation of trades, regardless of whether applicant had an improper intention or motive).

22 *See* NASD Conduct Rule 2110; *see also supra* note 2.

23 *Vail v. SEC*, 101 F.3d 37, 39 (5th Cir. 1996) (per curiam).

24 *See DiFrancesco*, 2012 WL 32128, at *5 n.18 (finding that applicant's conduct in downloading and taking confidential nonpublic information relating to approximately 36,000 customers was business-related because it involved his business relationship with his former firm and commercial relationships with his customers); *see also John Joseph Plunkett*, Exchange Act Release No. 69766, 2013 WL 2898033, at *7 & n.35 (June 14, 2013) (finding that applicant's conduct in moving confidential customer files to his new firm without first receiving the customers' consent was business-related because it included his relationship with his employer and commercial relationships with his customers).

25 *See Plunkett*, 2013 WL 2898033, at *7.

26 *Heath*, 2009 WL 56755, at *4 & n.5 (citing Restatement (Third) of Agency and Commission case law for the proposition that an agent has a duty not to use confidential information of the principal for his own, or a third-party's, interest, and is obligated to act in his customer's best interests).

it).[27] RJFS's privacy policies, which associates were required to follow, placed Tomlinson on notice of his obligation to maintain the confidentiality of customers' nonpublic information.[28] RJFS's Manual expressly instructed associates that they were responsible for protecting the confidentiality of customers' nonpublic information and were not allowed to share that information with third parties unless specifically authorized by the customer. Tomlinson acted in contravention of RJFS's policies.

We also find that Tomlinson's actions were "self-interested and for his own purposes."[29] Tomlinson favored his own financial interest in building a book of business over his customers' interests in the privacy of their confidential nonpublic information.[30] Moreover, the absence of

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27 *See Plunkett*, 2013 WL 2898033, at *7 (finding that an individual serving as firm president, chief compliance officer, general securities principal, and general securities representative breached his duty of confidentiality when he moved confidential customer files, including nonpublic information such as Social Security numbers, from his old firm to his new firm without first receiving customers' consent); *DiFrancesco*, 2012 WL 32128, at *6 (finding that registered representative breached his duty of confidentiality when he downloaded customers' confidential nonpublic information, including account numbers and net worth figures, and transmitted that information to his future branch manager at a competing firm); *Louis Feldman*, Exchange Act Release No. 34933, 52 SEC 19, 1994 WL 615120, at *2 (Nov. 3, 1994) (finding that firm's part owner, vice president, director, and general securities principal was required "under fundamental principles of agency law" to obtain prior consent of customers before transferring mutual fund accounts to another firm with which he was associated); *cf. Heath*, 2009 WL 56755, at *4 (finding that registered representative breached his duty of confidentiality when he disclosed to a future colleague at a competing firm material nonpublic information regarding a pending merger).

28 *See DiFrancesco*, 2012 WL 32128, at *6 (holding that applicant breached his duty of confidentiality, which was reflected in his firm's code of conduct); *Heath*, 2009 WL 56755 at *5 (stating that a firm's internal compliance policies inform a determination of whether conduct violates just and equitable principles of trade rules) & n.21 (citing authority).

29 *DiFrancesco*, 2012 WL 32128, at *6.

30 *See, e.g.*, *Plunkett*, 2013 WL 2898033, at *8 (finding that applicant acted out of self-interest and for his own personal gain when he transferred confidential client files to his new firm); *DiFrancesco*, 2012 WL 32128, at *6 (finding that applicant favored his own interest in maintaining his client base over customers' interest in the confidentiality of their nonpublic information); *Heath*, 2009 WL 56755, at *4 (finding that applicant's "disclosure was ultimately self-interested and for his, not his principal's, purposes," and concurring with the NYSE Hearing Panel's finding that the disclosure "was motivated by a desire to gain the trust of a future colleague").

demonstrable harm to customers does not excuse Tomlinson's actions.[31] Harm is not an element of a Rule 2110 violation.[32]

Tomlinson's hearing testimony demonstrates that he understood the types of customer information that were protected as "personally identifiable information," but that, as FINRA found, he "carelessly" granted Wells Fargo "unfettered" access to that information. Tomlinson's conduct compromised the privacy and security of RJFS and Credit Union customers' "nonpublic personal information" under Regulation S-P, prevented RJFS and the Credit Union from giving their customers reasonable notice and an opportunity to opt out of the disclosures, as required by Regulation S-P, and caused Wells Fargo, an unaffiliated third party, to receive confidential customer information improperly.

We find that Tomlinson's breach of customer confidentiality implicates quintessential ethical considerations and reflects negatively on his ability to comply with fundamental regulatory requirements and protect the privacy and security of customers' confidential information.[33] And in making this finding, we conclude that FINRA applied Rule 2110 in a manner consistent with the purposes of the Exchange Act. Accordingly, we sustain FINRA's findings that Tomlinson violated Rule 2110.

C. Tomlinson's arguments against liability lack merit.

Tomlinson argues that, as a branch manager and supervisor, he was authorized to download customers' confidential information. He also argues that he downloaded such information in an effort to "reach out" to customers whom he had assigned to other financial advisors.[34] But the fact that Tomlinson was authorized to download this information in the course of his employment with RJFS and the Credit Union did not mean that he was authorized to take it with him—and share it with third parties—when he left. To the contrary, RJFS's policies expressly prohibited him from sharing customers' confidential information with third

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31 *See DiFrancesco*, 2012 WL 32128, at *6 (stating that the absence of demonstrable customer harm does not excuse or mitigate the applicant's actions) & n.36 (citing *Heath*, 2009 WL 56755, at *9).

32 *See id.*

33 *See, e.g.*, *Daniel D. Manoff*, Exchange Act Release No. 46708, 55 SEC 1155, 2002 WL 31769236, at *4 (Oct. 23, 2002) (finding that applicant breached his duty to safeguard clients' personal financial information when he misappropriated his customer's credit card numbers and made four charges to his customer's credit card; stating that applicant's use of the credit card numbers constituted unethical, business-related conduct and called into question his ability to fulfill his fiduciary duties in handling other people's money).

34 *See supra* note 9.

parties without the customers' prior consent. Those policies undermine any assertion that he was acting within the scope of his employment.

Tomlinson also argues that the Credit Union knew for years that he used his personal flash drive to work on Credit Union business at home. Even if true, Tomlinson had no right to take that information with him when he changed firms. Tomlinson acknowledged in his hearing testimony that, in hindsight, he should have deleted all of the customer information from the flash drive before he resigned.

Tomlinson further argues that "no client personal identifiable information was disclosed to a third party" because the Wells Fargo assistant testified that she used a single file that contained only the names and addresses of his 160 customers. Regardless of whether the Wells Fargo assistant used only the names and addresses for 160 customers, Tomlinson "disclosed" 2,000 customers' nonpublic personal information, including customers' names, addresses, account numbers and balances, quarterly account statements, Social Security numbers, and birth dates, when he provided his flash drive to Wells Fargo personnel, thereby giving them access to that information.[35]

D. There is no evidence to support Tomlinson's assertion that the FINRA proceedings were biased or unfair.

Tomlinson raises a number of objections regarding the fairness of the proceedings before FINRA. First, Tomlinson argues that the "NAC appeal hearing" was a "sham" and that the outcome was "shocking," "predetermined," and taken in retaliation for appealing. According to Tomlinson, he was surprised by FINRA's decision against him because he had a "sense" that the NAC subcommittee members who heard his appeal "understood [his] side of the story about the 'role' and 'intended harm' that the Credit Union wanted in pushing FINRA to pursue" this action.[36] We have carefully reviewed the record and find no evidence of bias or unfairness

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[35] *See Plunkett*, 2013 WL 2898033, at *8 (finding that applicant violated Rule 2110 by providing firm's competitor with access to firm's records; rejecting applicant's argument that he did not violate Rule 2110 because the information was never used by the competitor).

[36] Tomlinson also argues that FINRA overreached in its enforcement because it acted on the complaint of the Credit Union, a non-FINRA member. We have held that FINRA's authority to enforce its rules is independent of a complaint. *Maximo Justo Guevara*, Exchange Act Release No. 42793, 54 SEC 655, 2000 WL 679607, at *6 (May 18, 2000) (stating that "NASD's power to enforce its rules is independent of a customer's decision not to complain"), & n.18 (citing cases). Tomlinson was a registered representative during the misconduct at issue, and thus was subject to FINRA's rules and jurisdiction. *See Toni Valentino*, Exchange Act Release No. 4925, 54 SEC 330, 2004 WL 300098, at *5 (Feb. 13, 2004) (finding that a registered representative, by registering, "consent[s] to abide by [FINRA's] rules"). FINRA was authorized to investigate his activities and pursue an enforcement action against him, regardless of the source of the complaint.

during the proceedings below. The fact that Tomlinson did not obtain the result he wanted or expected does not alone support a finding of bias.[37] Our *de novo* review of the record, followed by our independent decision concerning the validity of FINRA's allegations and sanctions, cures any procedural errors that may have been committed during the FINRA proceedings.[38]

Tomlinson's specific complaint appears to be that FINRA refused to provide him with the written recommendations of NAC subcommittee members or the minutes of the NAC's meeting.[39] Tomlinson does not point to, and we are unaware of, any FINRA rule that requires FINRA to provide him with these documents. Further, NASD's Code of Procedure "cannot be read to grant respondents the right to wholesale discovery of the NASD's files."[40] A respondent is not entitled to obtain internal NASD staff memoranda.[41]

Second, Tomlinson argues that FINRA improperly excluded from evidence a Raymond James Privacy Notice dated July 2012, which he claims contemplated the kind of disclosure at issue here.[42] The Privacy Notice disseminated by RJFS stated, in part, that financial advisors "may change brokerage and/or advisory firms and nonpublic personal information collected by your FA may be provided to the new firm so your FA can continue to service your account(s) at the new firm. If you do not want your financial advisor to use this information, please call" a toll-free number to opt out. Tomlinson argues that the Privacy Notice "allowed Financial Advisors to 'use non-public personal information' when changing broker dealers," and that is

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37 *Scott Epstein*, Exchange Act Release No. 59238, 2009 WL 223611, at *18 (Jan. 30, 2009) (stating that "[a]dverse rulings, by themselves, generally do not establish improper bias"), *aff'd*, 416 Fed. App'x 142 (3d Cir. 2010).

38 *See, e.g., Heath v. SEC*, 586 F.3d at 142 (stating that the Commission's *de novo* review of the record cures any procedural errors that may have been committed below).

39 The focus of Tomlinson's complaint about the fairness of his hearing before FINRA is somewhat ambiguous because he references both the Hearing Panel and NAC in his pleadings. But based on the context and names mentioned, it appears that Tomlinson is referring to the NAC.

40 *Michael Alan Leads*, Exchange Act Release No. 32437, 51 SEC 500, 1993 WL 204498, at *5 (June 9, 1993).

41 *David D. Esco, Jr.*, Exchange Act Release No. 14716, 46 SEC 1205, 1978 WL 207895, at *2 n.7 (Apr. 28, 1978). As noted above, our *de novo* review cures any prejudice that may have occurred before FINRA.

42 Tomlinson also complains about his "requests being denied to obtain a copy of the Privacy Statement for the period prior to 2008." Tomlinson does not indicate who denied his requests, nor does he indicate the relevancy of such a privacy notice to the finding that he breached his duty of client confidentiality.

what he did, using the "Christmas card list" (*i.e.*, customer names, addresses, and telephone numbers) to send announcements of his move to his 160 customers.

FINRA Rule 9263 allows the Hearing Officer to exclude evidence that is irrelevant or immaterial. The Hearing Panel found, and the NAC agreed, that the Raymond James Privacy Notice dated July 2012 was not relevant. We conclude that FINRA appropriately excluded the Privacy Notice on relevancy grounds because Tomlinson's conduct occurred in 2008.[43]

Tomlinson asserts that "[i]n the environment over the past few years it is hard to believe that Raymond James would relax [its] protection of personally identifiable information" and therefore the document should have been admitted. But Tomlinson overlooks that RJFS's Manual required that customers be given notice of and consent to a disclosure before the disclosure is made. In this case, there is no evidence that customers received notice of Tomlinson's actions. To the contrary, Tomlinson admitted that he did not notify anyone, including customers, that he would be disclosing their confidential nonpublic information to a third party.

Third, Tomlinson argues that FINRA admitted into evidence documents on his personal flash drive even though there was no proof of the dates on which he downloaded the documents. Tomlinson hypothesizes that some documents "could have come from the previous 3+ years of working at home with [the Credit Union's] 'full knowledge' of the information being transported." The download dates are not relevant—Tomlinson breached his duty of confidentiality by disclosing the protected information to his new firm. In any event, Tomlinson stipulated and admitted at the hearing that he downloaded the documents onto his personal flash drive in the days leading up to his resignation, the Credit Union's CIO testified about specific times when certain documents were downloaded, and a detailed timeline with dates and times was admitted into evidence without objection.

Finally, Tomlinson accuses the Credit Union of treating him unfairly in a variety of respects. For instance, he contends that the Credit Union tried to "paint as harmful a picture" of him as possible; retaliated against him by "pushing" FINRA to bring this proceeding; took "selective" action against him in "protecting' members' personally identifiable information";[44]

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43 Pending before us is FINRA's motion to strike two documents attached to Tomlinson's reply brief. The first document is a portion of what appears to be a Raymond James Privacy Notice from June 2014. The second document consists of Tomlinson's opening statement to the NAC, which is already contained in the record. Tomlinson did not move to admit either document into evidence under Rule of Practice 452 or attempt to meet Rule 452's standards. *See* 17 C.F.R. § 201.452. We see no basis on which to admit these documents, and we therefore grant FINRA's motion to strike.

44 Tomlinson argues that the Credit Union CIO knew of other security breaches that had occurred both before and after Tomlinson left the Credit Union, and that the CIO's "omission" of the breaches in his hearing testimony shows the "'selective nature' of the Corning Credit Union's action when it comes to 'protecting' members' personally identifiable information." Contrary to

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and "engaged in tortious interference with his business relations in an effort to bring harm to [him] financially and to his career." Tomlinson offers no evidence to support those accusations. Nor does he explain how any such evidence would be relevant to the issues before us. It appears that Tomlinson is seeking to shift the focus away from his own violation, but his efforts in this regard only serve to cast doubt on his commitment to the high standards of conduct demanded of him and indicate an unwillingness to fully accept responsibility for his misconduct.

III. Sanctions

Pursuant to Section 19(e)(2) of the Securities Exchange Act of 1934, we will sustain a FINRA sanction unless we find, "having due regard for the public interest and protection of investors," that the sanction is excessive or oppressive or imposes an unnecessary or inappropriate burden on competition.[45] As part of this review, we must consider any aggravating or mitigating factors[46] and whether the sanctions imposed by FINRA are remedial and not punitive.[47]

We initially observe that the sanctions imposed by the NAC are consistent with the Sanction Guidelines (the "Guidelines").[48] The Guidelines do not contain recommended sanctions for the specific misconduct at issue. Accordingly, the NAC properly considered the

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Tomlinson's argument, the CIO did, in fact, testify about two other incidents at the Credit Union involving the compromise of customer data. Whether those incidents are the ones to which he refers is unclear. In addition, Tomlinson does not explain how this testimony would have been relevant to whether he breached his duty of client confidentiality. To the extent he contends that he is a victim of selective prosecution, he fails to establish a claim. *See Plunkett*, 2013 WL 2898033, at *10 (setting forth elements of a claim for selective prosecution and finding that applicant failed to establish such a claim) & n.61 (citing authority).

45 15 U.S.C. § 78s(e)(2). Tomlinson does not contend, and the record does not show, that FINRA's sanctions imposed an unnecessary or inappropriate burden on competition.

46 *Saad v. SEC*, 718 F.3d 904, 906 (D.C. Cir. 2013); *Paz Sec., Inc. v. SEC*, 494 F.3d 1059, 1064-65 (D.C. Cir. 2007).

47 *Paz Sec.*, 494 F.3d at 1065 (stating that "[t]he purpose of the order [must be] remedial, not penal") (quoting *Wright v. SEC*, 112 F.2d 89, 94 (2d Cir. 1940)); *see also* FINRA Sanction Guidelines at 2 (stating that "[d]isciplinary sanctions are remedial in nature and should be designed to deter future misconduct and to improve overall business standards in the securities industry"), *available at* http://www.finra.org/web/groups/industry/@ip/@enf/@sg/documents/industry/p011038.pdf.

48 Although we are not bound by the Guidelines, we use them as a benchmark in conducting our review under Exchange Act Section 19(e)(2). *Plunkett*, 2013 WL 2898033, at *11.

Principal Considerations in Determining Sanctions applicable to all disciplinary proceedings in setting remedial sanctions.[49] The Principal Considerations identify several factors to be weighed, including whether the respondent accepted responsibility and acknowledged the misconduct to his employer;[50] whether the respondent engaged in numerous acts and/or a pattern of misconduct;[51] whether the respondent engaged in the misconduct over an extended period of time;[52] whether the respondent attempted to conceal his misconduct;[53] whether the respondent's misconduct was the result of an intentional act, recklessness, or negligence;[54] and whether the respondent's misconduct resulted in the potential for monetary or other gain.[55] The NAC's decision to suspend Tomlinson for ninety days in all capacities is supported by the application of these considerations.

The NAC found, and we agree, that Tomlinson "should have known that he had an obligation to maintain and safeguard customer information," and that he "carelessly" placed more than 2,000 RJFS and Credit Union customers' confidential information at risk when he left RJFS and the Credit Union and moved to Wells Fargo. RJFS's and Wells Fargo's policies put Tomlinson on notice of his obligations, but he disregarded them.

Moreover, the NAC found, and we agree, that Tomlinson, by virtue of his role as a supervisor, should have known that taking customers' confidential nonpublic information and disclosing it to a third party without the customers' consent violated Rule 2110.[56] Under RJFS's Manual, Tomlinson, as a supervisor, was responsible for understanding his obligations regarding confidential client information and ensuring that advisors under his supervision also complied with their obligations. Rather than protect confidential client information, Tomlinson used the access he had as a supervisor to take it for his own purposes. As the NAC found, the Hearing Panel failed to consider this factor in assessing sanctions.

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49 *See* FINRA Sanctions Guidelines, *supra* note 47, at 6-7 (setting forth a nonexhaustive list of factors that should be considered).

50 *Id.* at 6 (Principal Consideration No. 2).

51 *Id.* (Principal Consideration No. 8).

52 *Id.* (Principal Consideration No. 9).

53 *Id.* (Principal Consideration No. 10).

54 *Id.* at 7 (Principal Consideration No. 13).

55 *Id.* (Principal Consideration No. 17).

56 *Cf. Friedman*, 2011 WL 1825025, at *9 (finding aggravating that applicant was responsible for regulatory compliance at his firm).

The NAC further found several additional aggravating factors to be present. Tomlinson's misconduct resulted in his potential for monetary gain with respect to the customers who decided to open an account with him at Wells Fargo; his misconduct occurred over several days and late at night, which indicated that he acted in a "surreptitious manner"; and he sought to conceal his misconduct after he received the Credit Union's December 2008 letter by deleting files from his personal flash drive and personal laptop.[57] At the same time, the NAC found "no evidence that Tomlinson intended to harm customers or place their confidential information at risk," and that he "now acknowledges the potential harm that his mishandling of confidential customer information could have caused customers." The NAC also found that, although the absence of customer harm is not a mitigating factor,[58] the record did not show that customer information was misused as a result of Tomlinson's misconduct.

Given these circumstances, we agree with the NAC's determination to impose on Tomlinson a ninety-day suspension in all capacities. As we have stated, "[t]he ability to credibly assure a client that [confidential] information will be used solely to advance the client's own interests is central to any securities professional's ability to provide informed advice to clients."[59] In fact, the "[d]isclosure of such information jeopardizes the foundation of trust and confidence crucial to any professional advising relationship."[60] Tomlinson's misconduct showed a "careless" breach of his duty of client confidentiality.

Tomlinson argues that the ninety-day suspension is "career ending" and should be "eliminated or reduced."[61] He explains that "Wells Fargo has a policy to 'terminate' any representative with a suspension. I want to be able to 'rebuild' . . . my career, but a 90-day suspension would 'absolutely' end it." He points to the ten-business day suspension imposed on

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57 We also find that Tomlinson attempted to conceal his misconduct by failing to mention during his exit interview that he had customer information on his personal flash drive and laptop. It had to have been apparent to Tomlinson that the Credit Union did not want him to have such information on his personal devices. That was the reason why the Credit Union "wiped" Tomlinson's cell phone before returning it to him.

58 *Edward S. Brokaw*, Exchange Act Release No. 70883, 2013 WL 6044123, at *18 & n.137 (Nov. 15, 2013) (citing cases).

59 *Heath*, 2009 WL 56755, at *10.

60 *Id.*

61 Tomlinson also requests that the monetary fine be "removed." As discussed, the NAC upheld the fine but declined to impose it or order costs based on Tomlinson's demonstrated inability to pay.

the applicant in *Dante J. DiFrancesco*,[62] a similar breach of client confidentiality case, to demonstrate the unfairness of his 90-day suspension.

It is well-settled that the appropriate sanction in any case "depends on the facts and circumstances of each case and cannot be precisely determined by comparison with action taken in other proceedings."[63] The facts and circumstances of this case fully support a ninety-day suspension. As FINRA found, Tomlinson "carelessly" placed more than 2,000 RJFS and Credit Union customers' confidential information at risk when he moved to Wells Fargo. Despite being instructed repeatedly by RJFS and Wells Fargo not to take or disclose customers' confidential nonpublic information, Tomlinson did so for his own financial purpose and benefit. Then, when the misconduct was discovered, he attempted to conceal it by deleting the information on his personal flash drive and personal laptop.

Tomlinson argues that the NAC increased the suspension to "offset" his inability to pay the fine and as "retribution" for his appeal. But the "mere fact that the NAC increased the sanctions . . . does not render the [sanctions] invalid on fairness grounds."[64] Tomlinson states that the NAC's refusal to impose the fine is "extremely helpful," but contends that the suspension "is 'far more costly' . . . to a career that has lasted 32 years without a customer complaint."[65] Tomlinson asserts that "[a]lot has been learned over the past 5 1/2 years" and that he is "more than contrite and extremely remorseful for the impact [this action] has had on [his] family." While we acknowledge Tomlinson's concerns, we have stated previously that "[h]ow a

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62 Exchange Act Release No. 66113, 2012 WL 32128 (Jan. 6, 2012).

63 *Gary M. Kornman*, Exchange Act Release No. 59403, 2009 WL 367635, at *9 (Feb. 13, 2009), *petition denied*, 592 F.3d 173 (D.C. Cir. 2010); *see also Butz v. Glover Livestock Comm'n Co.*, 411 U.S. 182, 187 (1973) (holding that "employment of a sanction within the authority of an administrative agency is . . . not rendered invalid in a particular case because it is more severe than sanctions imposed in other cases"). In any event, there are aggravating facts in this case that justify greater sanctions. First, Tomlinson admitted that he downloaded confidential information concerning more than 2,000 customers, most of whom were assigned to other advisors and with whom he had no business relationship. In *DiFrancesco*, by contrast, the applicant intended to download information relating only to his customers, but inadvertently downloaded information pertaining to tens of thousands of other firm customers. Second, Tomlinson was a supervisor charged with responsibility for ensuring that associates safeguard customers' confidential information. In *DiFrancesco*, by contrast, the applicant had a non-supervisory role at his firm.

64 *Joseph Abbondante*, Exchange Act Release No. 53066, 58 SEC 1082, 2006 WL 42393, at *11 (Jan. 6, 2006), *petition denied*, 209 Fed. App'x 6 (2d Cir. 2006).

65 In his brief, Tomlinson states: "I want to make clear that there is 'no misunderstanding' on my part of the concern to customer privacy and keeping safe clients' personal information. Over my 32 year career, I never even told my wife 'who my clients were' . . . . So did I do something dumb, yes, but not with any 'malicious intent' or for a 'nefarious nature.'"

respondent collaterally suffers as a result of the violation, or from the disciplinary proceeding that followed (*e.g.*, that he lost money, the amount of time he was out of the industry, or the impact the disciplinary proceeding had on his reputation, career, or finances) is not a mitigating factor."[66]

* * *

We conclude that the ninety-day sanction imposed on Tomlinson serves a remedial purpose of protecting public investors and deterring future misconduct without being excessive or oppressive. This sanction reflects the importance of a security professional's obligation to safeguard confidential customer information, and is a measured response to Tomlinson's careless breach of that obligation.

An appropriate order will issue.

By the Commission (Chair WHITE and Commissioners AGUILAR, GALLAGHER, and STEIN; Commissioner PIWOWAR not participating).

Brent J. Fields
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

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66 *Johnny Clifton*, Securities Act Release No. 9417, 2013 WL 3487076, at *16 n.116 (July 12, 2013). In addition, FINRA has found that the lack of a disciplinary record is not mitigating for purposes of sanctions. *See Kent M. Houston*, Exchange Act Release No. 71589, 2014 WL 651953, at *7 (Feb. 20, 2014).

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No.

Admin. Proc. File No. 3-15824

In the Matter of the Application of STEVEN ROBERT TOMLINSON For Review of Disciplinary Action Taken By FINRA

ORDER SUSTAINING DISCIPLINARY ACTION

On the basis of the Commission's opinion issued this day, it is

ORDERED that the disciplinary action taken and sanction imposed by FINRA against Steven Robert Tomlinson be, and they hereby are, sustained.

By the Commission.

Brent J. Fields
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73835 / December 15, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3611 / December 15, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16314

In the Matter of **BRUKER CORPORATION,** **Respondent.**	**ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act"), against Bruker Corporation ("Bruker" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, Respondent consents to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

Summary

1. This matter concerns violations of the books and records and internal controls provisions of the Foreign Corrupt Practices Act ("FCPA") by Bruker. The violations took place from at least 2005 through 2011 and occurred throughout Bruker's China operations. Employees of the China offices of four Bruker subsidiaries (collectively, the "Bruker China Offices") made unlawful payments of approximately $230,938 to government officials ("Chinese government officials") who were employed by state owned entities ("SOEs") in China that were Bruker customers. These payments were made to obtain or retain business from the SOEs for the Bruker China Offices. Specifically, all of the Bruker China Offices provided non-business related travel to Chinese government officials, and one Bruker China Office also paid Chinese government officials under "research cooperation" ventures and "collaboration" agreements (collectively, the "Collaboration Agreements") for which there was no legitimate business purpose. Bruker realized approximately $1.7 million in profits from sales contracts with SOEs whose officials received the improper payments.

2. The payments to the Chinese government officials were recorded as legitimate business and marketing expenses in the Bruker China Offices' books and records, when in fact they were improper payments designed to personally benefit the officials. The Bruker China Offices' books and records were consolidated into Bruker's books and records, thereby causing Bruker's books and records to be inaccurate. Bruker failed to devise and maintain an adequate system of internal accounting controls sufficient to prevent and detect the improper payments that occurred over several years.

Respondent

3. Bruker Corporation is a Delaware corporation with its headquarters in Billerica, Massachusetts. Bruker designs, manufactures, and markets analytical tools and life science and materials research systems (e.g., infrared spectrometers and microscopes) and maintains operations in North America, Europe, and China. Bruker manages its China operations through the Shanghai and Beijing representative offices of the Asia-based subsidiaries of four Bruker divisions: Bruker Optics, Bruker BioSpin, Bruker Daltonics, and Bruker Materials (formerly Bruker AXS). Bruker's common stock is registered with the Commission pursuant to Section 12(g) of the Exchange Act and is listed on the NASDAQ Global Select Market (ticker: BRKR).

Facts

A. The Bruker China Offices Improperly Funded Leisure Travel for Chinese Government Officials

4. The Bruker China Offices funded leisure travel for Chinese government officials to visit the United States, the Czech Republic, Norway, Sweden, France, Germany, Switzerland and Italy. These leisure trips typically followed business-related travel funded by the Bruker China Offices. The Chinese government officials who went on the trips often authorized the purchase of

products from the Bruker China Offices. For example, during 2006, as part of a sales contract with an SOE, a Bruker China Office paid for purported training expenses for a Chinese government official (who signed the sales contract on behalf of the SOE). In fact, the payment included reimbursement for sightseeing, tour tickets, shopping and other leisure activities in Frankfurt and Paris. Also, in 2007, a Bruker China Office paid for three Chinese government officials to visit Sweden for a conference, but included as part of the travel, several days of sightseeing in Sweden, Finland, and Norway.

5. The Bruker China Offices also funded certain trips for Chinese government officials that had no legitimate business component. For example, during 2009, a Bruker China Office paid for two Chinese government officials to travel to New York, despite the lack of any Bruker facilities there, and to Los Angeles, where they engaged in sightseeing activities. Also during 2009, a Bruker China Office paid for three Chinese government officials to visit destinations in Europe for sightseeing. In another instance, during 2010, a Bruker China Office paid for three Chinese government officials to visit Frankfurt, Heidelberg, Stuttgart, and Munich, in Germany, as well as Salzburg, Liz, Innsbruck, Graz, and Vienna, in Austria. And in 2011, a Bruker China Office paid for Chinese government officials from seven SOEs to go on sightseeing visits to Europe, including Austria, France, Switzerland, Italy, and the Czech Republic. In certain cases, the Chinese government officials who went on these trips were involved in purchasing products from the Bruker China Offices.

6. Overall, from 2005 through 2011, the Bruker China Offices paid approximately $119,710 to fund 17 trips for Chinese government officials that were for the most part not related to any legitimate business purpose. These trips were recorded in Bruker's books and records as business expenses, without any indication that they were primarily for sightseeing and other non-business related activities. Bruker improperly profited by $1,131,740 from contracts obtained from the SOEs whose officials participated on these trips.

B. A Bruker China Office Improperly Funneled Payments to Officials of SOEs Under the Guise of Collaboration and Research Agreements

7. From 2008 through 2011, a Bruker China Office paid $111,228 to Chinese government officials pursuant to 12 suspect Collaboration Agreements. Generally, under these Collaboration Agreements, the SOEs had to provide research on Bruker products, or had to use Bruker products in demonstration laboratories. However, the Collaboration Agreements did not specify the work product that the SOEs had to provide to be paid, and no work product was in fact provided to the Bruker China Office by the SOEs. Also, certain Collaboration Agreements were executed directly with a Chinese government official, rather than the SOE itself; in some cases, the Bruker China Office paid the Chinese government official directly. And at times, the Chinese government officials who signed the Collaboration Agreements or obtained payments under the Agreements were involved in purchasing products from the Bruker China Office. Bruker profited by approximately $583,112 from contracts improperly obtained from the SOEs whose officials received payments under the Collaboration Agreements.

C. Bruker Failed to Implement an Adequate Internal Controls System

8. From at least 2005 through 2011, Bruker failed to implement an adequate internal controls system to address the potential FCPA problems posed by its ownership of the Bruker China Offices, which sold their products primarily to SOEs. For example, Bruker did not translate its training presentations on FCPA, ethics, or compliance issues into local languages, including Mandarin. And although Bruker implemented an FCPA policy in 2006, it failed to translate that policy into Mandarin and relied mainly on its China-based managers to ensure that employees understood the potential FCPA implications of doing business with SOEs. Also, while Bruker periodically distributed its Code of Conduct (containing its gifts and entertainment policies) and employee handbook to employees worldwide, it again failed to translate these documents into local languages, including Chinese. Likewise, Bruker's toll free employee hotline, which employees were to use to report complaints anonymously, was not provided in Mandarin, limiting its efficacy.

9. Bruker also failed to adequately monitor and supervise the senior executives at the Bruker China Offices to ensure that they enforced anti-corruption policies or kept accurate records concerning payments to Chinese government officials. The Bruker China Offices had no independent compliance staff or an internal audit function that had authority to intervene into management decisions and, if appropriate, take remedial actions. Bruker also failed to tailor its preapproval processes for conditions in China, instead allowing the Bruker China Offices approval over items such as nonemployee travel and changes to contracts. As a result, senior employees of the Bruker China Offices had unsupervised control over the compliance process; these employees in turn abused their privileges, approving suspect payments to Chinese government officials for non-business related travel and for purported Collaboration Agreements.

D. Discovery, Internal Investigation, and Self-Reporting

10. Bruker discovered the improper payments to Chinese government officials during 2011 while investigating the misappropriation of company funds by certain employees of a Bruker China Office. Upon learning about these payments, Bruker's board of directors promptly initiated an investigation, with the assistance of independent outside counsel and an independent forensic consulting firm. Bruker self-reported the preliminary results of its internal investigation to both the staff of the Commission and to the Department of Justice. Thereafter, Bruker, on its own initiative, undertook a broad review of the China operations of its other divisions. To the extent this internal review identified additional issues of concern, Bruker fully shared its findings with the staff.

11. As part of its internal review and investigation, Bruker promptly undertook significant remedial measures including terminating the senior staff at each of the Bruker China Offices. Bruker also revised its pre-existing compliance program, updated and enhanced its financial accounting controls and its compliance protocols and policies, and implemented those enhancements in China, and thereafter around the world. These steps included: (1) instituting pre-approval processes for nonemployee travel and significant changes to contracts; (2) establishing a new internal audit function and hiring a new director of internal audit who is charged with oversight over Bruker's global compliance program, including FCPA compliance; (3) adopting an

amended FCPA policy translated into local languages; (4) implementing an enhanced FCPA training program, which includes training programs in local languages as well as mandatory online employee training programs regarding ethics and FCPA compliance; (5) enhancing due diligence procedures for third-parties; and (6) implementing a new global whistleblower hotline.

12. Throughout the process, Bruker provided extensive, thorough, and real-time cooperation with the Commission. In addition to self-reporting to the Commission shortly after discovering the FCPA violations, Bruker voluntarily provided the Commission with real-time reports of its investigative findings; shared its analysis of important documents and summaries of witness interviews; expanded the scope of the investigation at the Commission's request; and responded to the Commission's requests for documents and information in a timely manner. These actions assisted the Commission in efficiently collecting valuable evidence, including information that may not have been otherwise available to the staff.

Legal Standards and Violations

A. Legal Standards

13. Under Section 21C(a) of the Exchange Act, the Commission may impose a cease-and-desist order upon any person who is violating, has violated, or is about to violate any provision of the Exchange Act or any regulation thereunder, and upon any other person that is, was, or would be a cause of the violation, due to an act or omission the person knew or should have known would contribute to such violation.

14. The FCPA, enacted in 1977, added Section 13(b)(2)(A) to the Exchange Act to require reporting companies to make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and disposition of the assets of the issuer. 15 U.S.C. § 78m(b)(2)(A).

15. The FCPA also added Section 13(b)(2)(B) to the Exchange Act to require reporting companies to, among other things, devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that the transactions: (i) are executed in accordance with management's general or specific authorization; and (ii) are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles ("GAAP") or any other criteria applicable to such statements, and to maintain accountability for assets. 15 U.S.C. § 78m(b)(2)(B).

B. Bruker Violated Section 13(b)(2) of the Exchange Act

16. The Bruker China Offices made payments to Chinese government officials that they improperly recorded on their books and records as legitimate business and marketing expenses. The books and records of the Bruker China Offices were consolidated into Bruker's books and records. As a result of the misconduct of its subsidiaries, Bruker failed to make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflected its

transactions and the disposition of its assets as required by Section 13(b)(2)(A) of the Exchange Act.

17. The improper payments described above took place over several years and throughout Bruker's China operations. Bruker failed to implement an adequate system of internal controls, including an appropriate FCPA compliance and training program at its Bruker China Offices, which was commensurate with the risks of doing business in China, and particularly the risks of businesses that sold products primarily to SOEs. Accordingly, in violation of Section 13(b)(2)(B) of the Exchange Act, Bruker failed to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that it maintained accountability for its assets, and that its transactions were executed in accordance with management's authorization and recorded as necessary to permit the preparation of financial statements in conformity with GAAP.

Commission Consideration of Bruker's Cooperation and Remedial Efforts

18. In determining to accept the Offer, the Commission considered remedial acts promptly undertaken by Bruker and the significant cooperation it afforded to the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Bruker's Offer.

Accordingly, it is hereby ORDERED that:

A. Pursuant to Section 21C of the Exchange Act, Respondent Bruker cease and desist from committing or causing any violations and any future violations of Sections 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act.

B. Respondent shall, within ten (10) days of the entry of this Order, pay $2,399,969 to the United States Treasury, including $1,714,852 in disgorgement, $310,117 in prejudgment interest, and a civil monetary penalty of $375,000. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600 and 31 U.S.C. § 3717. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Bruker as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Paul G. Block, Assistant Director, Foreign Corrupt Practices Act Unit, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, Suite 2300, Boston, Massachusetts 02110.

C. Respondent acknowledges that the Commission is not imposing a civil penalty in excess of $375,000 based upon its cooperation in a Commission investigation and related enforcement action. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, the Division may, at its sole discretion and with prior notice to the Respondent, petition the Commission to reopen this matter and seek an order directing that the Respondent pay an additional civil penalty. Respondent may contest by way of defense in any resulting administrative proceeding whether it knowingly provided materially false or misleading information, but may not: (1) contest the findings in the Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

By the Commission.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73839 / December 15, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3613 / December 15, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16315

In the Matter of CANADIAN SOLAR, INC. and YAN ZHUANG, Respondents.	ORDER INSTITUTING CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 21C OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING A CEASE-AND-DESIST ORDER AND CIVIL PENALTIES

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 21C of the Securities Exchange Act of 1934 ("Exchange Act") against Canadian Solar, Inc. ("CSI" or "Canadian Solar") and Yan Zhuang ("Zhuang") (collectively, "Respondents").

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers"), which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which are admitted, Respondents consent to the entry of this Order Instituting Cease-and-Desist Proceedings Pursuant to Section 21C of the Securities Exchange Act of 1934, Making Findings, and Imposing a Cease-and-Desist Order and Civil Penalties ("Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds that:

A. SUMMARY

This matter arises from Canadian Solar's violations of the reporting, books and records, and internal controls provisions of the Exchange Act resulting from CSI's recognition of revenue for certain transactions with United States ("U.S.") customers during the second, third, and fourth quarters of 2009 even though certain criteria for revenue recognition had not been met. Yan Zhuang, CSI's Vice President of Global Sales and Marketing during the relevant period, was a cause of CSI's violations. In addition, by directing a customer to make certain revisions to purchase orders, Zhuang also violated Section 13(b)(5) of the Exchange Act.

B. RESPONDENTS

Canadian Solar, Inc. is a Canadian corporation headquartered in Ontario that designs, develops, manufactures and markets solar power products. Canadian Solar has its principal place of business in Suzhou, People's Republic of China ("PRC"), and has a U.S. head office and customer center in San Ramon, California. Canadian Solar is a foreign private issuer of securities registered with the Commission pursuant to Section 12(b) of the Exchange Act and quoted on NASDAQ under the ticker symbol CSIQ.

Yan Zhuang, age 49, is a resident of the PRC. Zhuang has been Senior Vice President and Chief Commercial Officer of Canadian Solar since May 2012. From July 2011 until May 2012, Zhuang was Senior Vice President of Global Sales and Marketing. From June 2009 until July 2011, and during the relevant period, Zhuang was Vice President of Global Sales and Marketing. From September 2007 until June 2009, Zhuang was an independent director of CSI.

C. FACTS

Beginning in 2006 with its initial public offering in the United States, CSI—which, since starting operations in 2001, had focused primarily on the European market— publicly stated its intentions "to expand into the U.S. market" as a result of new government incentives in select states.

To facilitate its U.S. expansion, in 2007, by which time at least six states were offering incentives to developers of solar projects, CSI set up an office in Phoenix, Arizona and incorporated a U.S. subsidiary. In 2007, however, CSI's revenue from the U.S. was still only $2.6 million or less than 1% of CSI's reported annual revenue.[1]

In 2008 and 2009, CSI continued its U.S. expansion efforts. During 2008, CSI entered into a distributorship with a California company and by early 2009 opened a sales office in San Ramon, California. At the time, CSI announced in a press release that it was "increasing its footprint in anticipation of the U.S. becoming a significant market" and that it "expect[ed] to see substantial growth in the U.S. in 2009."

By the end of 2008, CSI's publicly reported U.S. revenue increased to $32.3 million and accounted for approximately 4.6% of CSI's revenue. CSI continued to demonstrate growth in the U.S. in 2009: For the second quarter of 2009, CSI reported "strong sales growth in Asia and America, with sequential gains of 188% and 500%, respectively, over Q109, resulting in a diversified and balanced global market distribution." For the third quarter of 2009, CSI reported U.S. revenue of $12.9 million or 6% of CSI's revenues and for the fourth quarter of 2009, U.S. revenue of $24.8 million, or 8.6% of revenues. For the full year 2009, approximately 8.5% of CSI's revenue was generated from the U.S.

However, CSI's depiction of steady growth in the U.S. market in 2009 was inaccurate because CSI recognized revenue from certain transactions during the second, third, and fourth quarters of 2009 which failed to meet all of the criteria for revenue recognition.

<u>Relevant Accounting Standards</u>

In determining whether to recognize revenue during an accounting period, U.S. Generally Accepted Accounting Principles ("GAAP") require an entity to consider whether (1) the revenue is realized or realizable and (2) the revenue is earned.

Revenue is realizable when related assets received or held are readily convertible to known amounts of cash or claims to cash. Revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues. Revenue is realized and earned when <u>all</u> of the following criteria are met:

(i) Persuasive evidence of an arrangement exists;
(ii) Delivery has occurred or services have been rendered;
(iii) The seller's price to the buyer is fixed and determinable; and
(iv) Collectability is reasonably assured.

Each of the four conditions must be met by the end of an accounting period in order to recognize revenue from a particular transaction. If any condition fails to be satisfied, revenue

[1] During the relevant period, CSI's U.S. revenue was reported within the "America" geographic region. While the "America" region included some revenue from Canadian customers, most of it was derived from U.S. customers.

recognition must be deferred until the period in which the condition is met. *See, e.g.*, Accounting Standards Codification ("ASC") 605-10-25-1. *See also* ASC 605-10-S99-1.

<u>Customer A</u>

In April 2009, CSI began discussions to supply a California-based solar power contractor ("Customer A") with solar modules for two large-scale municipal projects in California and Florida, transactions that CSI anticipated would yield over $7.7 million in revenue.

Upon completion of the two projects, Customer A expected large U.S. government subsidies and significant income, but Customer A required financing to cover the initial costs associated with purchasing the solar modules. CSI had access to financing from Chinese banks, in addition to the ability to obtain credit insurance from a Chinese government-funded entity established to promote foreign trade.[2] CSI concluded that by utilizing these resources it could provide or arrange for the financing Customer A required.

While negotiations over the terms of the transaction were ongoing, CSI began to manufacture and ship solar modules to Customer A. On June 23, 2009, CSI shipped its first batch of solar modules to Customer A's Florida project, whereupon it recorded $1.2 million in revenue.[3] On June 30, 2009, CSI shipped a second batch of modules to Customer A's Florida project, recognizing an additional $1.2 million in revenue.

<u>Evidence of an arrangement</u>

It was improper for CSI to recognize this $2.4 million in revenue in the second quarter of 2009. First, negotiations between Customer A and CSI regarding the final financing for the transaction remained ongoing into the third quarter of 2009. By the third quarter, the parties had still not determined how Customer A would pay for the entirety of the panels required for the large-scale projects.

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2 This entity (the "Insurer") provided insurance against losses from a particular customer for a defined payment term and up to a specific amount. For example, in a typical arrangement, the Insurer might agree to provide credit insurance up to $3 million for a customer with a 90-day payment term. If the customer defaulted, CSI could file a claim with the Insurer seeking reimbursement of between 70% - 90% of its resulting loss. Any amount of credit CSI extended to a particular customer above the agreed credit limit would not be covered by the Insurer. Accordingly, in the above example, if CSI allowed the customer to purchase $5 million worth of product, only $3 million would be covered by the Insurer. In addition, allowing payment terms beyond those dictated by the Insurer nullified the insurance. Therefore, if CSI allowed the customer more than 90 days to pay for product, the Insurer would not protect against losses upon the customer's default.

3 Pursuant to its revenue recognition policy at the time, CSI recorded revenue for the sale of solar panels when title had passed to the customer. Under CSI's customary shipping terms, this usually occurred when a product shipped from its place of origin in China.

Collectability

CSI recognized the revenue from sales to Customer A, even though CSI questioned whether it would be able to collect payment for these sales. In particular, at the time that CSI shipped the first two batches of solar modules to Customer A and recognized the corresponding revenue, CSI expressed reservations about Customer A's ability to pay. For example, shortly before shipment, Zhuang noted Customer A's poor Dun & Bradstreet credit report and "I am raising several yellow flags about [Customer A] here – I have been watching them closely! . . . They are very short money. They are not confident they can pay us on November 1st and not confident enough to find money to finish the project." Nevertheless, CSI shipped the modules and recognized revenue.

Despite shipping modules to Customer A in June 2009 and recognizing $2.4 million in revenue, and shipping additional modules in July and August 2009, negotiations between the parties fell apart in mid-September 2009. As a result, CSI repossessed all of the modules it had already shipped.

Customer B

a. Second Quarter

CSI also recognized $3.4 million of revenue in the second quarter of 2009 from transactions with Customer B, a preferred distributor of CSI, when not all the criteria for revenue recognition had been met.

Fixed and determinable price

Commencing in the second quarter of 2009, in its transactions with Customer B, CSI at times reduced the price of solar modules already shipped, even though revenue had already been recognized. This practice was a way for CSI to effectively guarantee Customer B against losses by adjusting Customer B's price below that which Customer B could expect on resale. For example, in June 2009, Zhuang directed sales personnel to "drop the price of [Customer B's] inventory . . . Need them to move the goods to pay us." Zhuang also indicated that CSI might further reduce Customer B's price in the future, directing sales personnel to "be prepared to further lower the price if their inventory still does not move soon. We need them to sell out to pay us back." Absent a fixed or determinable price, it was improper for Canadian Solar to recognize revenue of $3.4 million on sales to Customer B in the second quarter of 2009.

Collectability

Collectability was also questionable for CSI's sales to Customer B in the second quarter of 2009. In particular, after initial shipments to Customer B in the second quarter, CSI's outstanding accounts receivable balance for Customer B exceeded the limit of the Insurer's credit insurance coverage.[4] Customer B submitted additional purchase orders, one of which sought an additional $2.3 million in solar modules to be shipped within the second quarter of 2009. Although Customer B committed to a payment plan, CSI personnel expressed concern about further increasing CSI's credit risk by shipping additional product before Customer B paid down its account balance.

Ultimately, CSI developed a plan to expand its warehouse capacity in Northern California and, beginning in June 2009, ship product to this warehouse instead of shipping directly to Customer B. Pursuant to the plan, CSI would release solar modules to Customer B in installments as Customer B paid down its outstanding balance pursuant to an agreed-upon schedule. At the time this plan was developed, Zhuang and others understood that CSI could not recognize revenue associated with shipments to its own warehouse until Customer B made payment and picked up the solar modules from CSI's warehouse.

After this plan was developed, the Insurer's limit for Customer B was raised from $1 million to $3 million. When CSI's sales team learned this, they sought permission to ship additional containers directly to Customer B rather than shipping to CSI's warehouse. By doing so, CSI would avoid extra handling and storage fees. Zhuang was firm, however, that CSI should stick with the original storage and payment plan: "We had a good plan! [Customer B] still owe [sic] $1M and most of the panels are still sitting in their inventory. We lowered our price to help them to sell out. I do not want to ship more to their warehouse without their promised payment monthly before they clear their inventory significantly. . . I already gave the final decision in my previous mail. This is final!"

Despite this decision, CSI discovered that its Northern California warehouse could not store as many containers as planned. Therefore, rather than following the original storage and payment plan, CSI released containers directly to Customer B and booked revenue for those panels. Although Zhuang earlier had insisted that the existing payment plan be followed, instead he directed CSI personnel to "ask for a payment plan and try to ship more to [Customer B]. Revenue not recognized by shipping to our warehouse."

In addition, the decision to abandon the original storage and payment plan and to ship the containers directly to Customer B was not made until after the close of the second quarter of 2009. However, revenue from solar modules shipped to Customer B in the third quarter of 2009 was booked in the second quarter.

The recognition of this revenue relating to Customers A and B was publicly reported in a press release and filed with the Commission on Form 6-K. This revenue accounted for 36% of CSI's second-quarter 2009 U.S. revenue and 5% of CSI's second-quarter 2009 global revenue.

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4 The Insurer subsequently raised the limit, although Customer B's outstanding balance ultimately exceeded the higher limit as well.

b. Third Quarter

Collectability

In the third quarter of 2009, CSI recognized revenue of $3.7 million from sales to Customer B even though collectability was doubtful. This transaction, which was booked at the very end of the third quarter, resulted from CSI's failure to finalize the deal with Customer A, described above. Faced with the anticipated return of a large quantity of modules previously shipped to Customer A during a period of falling prices and having to reverse revenue already recognized in the second and third quarters of 2009, CSI sought to resell the solar modules repossessed from Customer A. At Zhuang's direction, all modules repossessed from Customer A that could not be resold to other customers were resold to Customer B.

Collectability, however, was questionable because Customer B already had a large outstanding balance at the time of the transaction, as well as substantial unsold inventory from prior purchases. CSI committed its own sales force to help Customer B in reselling the repossessed modules to end users, and CSI did not require Customer B to pay for the modules until reselling them.

Zhuang and others understood that Customer B owed substantial sums for prior purchases, and questioned whether Customer B would be able to pay for additional shipments. In fact, immediately prior to redirecting the return from Customer A to Customer B, CSI personnel were instructed, "If you can divert to other credible customers then it should be done first – let all sales managers know and push them!!!! The rest goes to [Customer B] – as their [Accounts Receivable] will be 5 month [sic] old soon (2 months overdue)."

Further, CSI agreed as part of the transaction to reimburse Customer B for costs it incurred in storing the inventory CSI shipped. This agreement was reflected in a purchase order Customer B sent to CSI, which indicated that CSI was to pay Customer B's storage fees. However, Zhuang directed Customer B to "delete the storage fee from the PO. We can not realize sales for Q3 with this line. We can have a separate contract on the storage fee and I will approve it." In addition, the actual purchase orders for this transaction were not completed until October 2009. At Zhuang's direction, Customer B dated the purchase orders for September 29, the date when some of the panels were shipped to Customer B.

The recognition of this revenue relating to Customer B was publicly reported in a press release and filed with the Commission on Form 6-K. This revenue accounted for 29% of CSI's third-quarter U.S. revenue and 1.7% of CSI's third-quarter global revenue.

Revision of Fourth Quarter

On March 3, 2010, CSI publicly announced its financial results for the fourth quarter of 2009 in a press release filed with the Commission on Form 6-K. CSI reported U.S. revenue of $24.8 million and identified U.S. revenue as 8.6% of CSI's total revenues.

In August 2010, CSI revised its previously reported earnings for the fourth quarter of 2009. One portion of the revision related to revenue recognition, resulting in a $19.5 million reduction in CSI's fourth-quarter 2009 U.S. revenue from $24.8 million to $5.3 million to account for (1) products shipped in the fourth quarter of 2009 for which collection was not reasonably assured, and (2) a sales return reserve that CSI began to accrue for the fourth quarter 2009 forward. CSI did not revise its previously reported earnings for the second and third quarters of 2009.

Internal Controls

CSI was able to recognize revenue from the above-described transactions, due to CSI's deficient internal control over financial reporting. Both CSI's management and its independent auditor concluded that as of December 31, 2009, there were material weaknesses in the effectiveness of CSI's internal control over its financial reporting. These deficiencies included, among others, the failure to establish effective controls to ensure that all revenue recognition criteria were met prior to recognizing revenue and a control to monitor sales returns and record a reserve related to estimated sales returns.

D. VIOLATIONS

Section 13(a) of the Exchange Act and Rule 13a-16 thereunder require every foreign private issuer of a security registered pursuant to Section 12 of the Exchange Act to file with the Commission such information, documents and reports as the Commission may require, and, pursuant to Rule 12b-20 of the Exchange Act, mandate that such reports contain such further material information as may be necessary to make the required statements not misleading.

Section 13(b)(2)(A) of the Exchange Act requires reporting companies to make and keep books, records and accounts, which, in reasonable detail, accurately reflect their transactions and dispositions of their assets, and prohibit any person from, directly or indirectly, falsifying or causing to be falsified, any book, record or account subject to Section 13(b)(2)(A).

Section 13(b)(2)(B) of the Exchange Act requires all reporting companies to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP.

Section 13(b)(5) of the Exchange Act prohibits any person from knowingly circumventing a system of accounting controls or knowingly falsifying any book, record, or account subject to Section 13(b)(2)(A).

Canadian Solar

As a result of the conduct described above, CSI violated Section 13(a) of the Exchange Act and Rules 12b-20 and 13a-16 thereunder by reporting inaccurate U.S. revenue in its quarterly earnings reports for the second, third, and fourth quarters of 2009 by including revenue for certain transactions when the criteria for revenue recognition had not been met.

As a result of the conduct described above, CSI violated Section 13(b)(2)(A) of the Exchange Act because it did not keep books, records, or accounts that accurately reflected the amount of U.S. revenue it had earned.

As a result of the conduct described above, CSI violated Section 13(b)(2)(B) of the Exchange Act because it failed to maintain a system of internal accounting controls sufficient to provide reasonable assurances that it was recognizing revenue in accordance with GAAP.

Yan Zhuang

As a result of the conduct described above, Zhuang knew or should have known that CSI was improperly recognizing revenue with respect to certain transactions with U.S. customers. As a result of the conduct described above, Zhuang caused or was a cause of CSI's violations of Section 13(a) and 13(b)(2)(A) of the Exchange Act and Rules 12b-20 and 13a-16 thereunder. In addition, by directing Customer B to make certain revisions to purchase orders, Zhuang violated Section 13(b)(5) of the Exchange Act.

E. CSI'S REMEDIAL MEASURES

In determining to accept the Offers of Settlement, the Commission considered remedial acts undertaken by CSI.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondents' Offers.

Accordingly, pursuant to Sections 21C and 21B of the Exchange Act, it is hereby ORDERED that:

A. Respondent Canadian Solar cease and desist from committing or causing any violations and any future violations of Section 13(a) and Sections 13(b)(2)(A) and (B) of the Exchange Act and Rules 12b-20 and 13a-16 thereunder.

B. Respondent Yan Zhuang cease and desist from committing or causing any violations and any future violations of Sections 13(a), 13(b)(2)(A) and 13(b)(5) of the Exchange Act and Rules 12b-20 and 13a-16 thereunder.

C. Within 30 days of the entry of this Order:

a. Respondent Canadian Solar shall pay to the United States Treasury a civil money penalty in the amount of $500,000;

b. Respondent Yan Zhuang shall pay to the United States Treasury a civil money penalty of $50,000.

If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways: (1) Respondents may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request; (2) Respondents may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or (3) Respondents may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying the payer as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Amy L. Friedman, Assistant Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549-5010A.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Gallagher
Commissioner Piwowar
Disapproved

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C.

SECURITIES ACT OF 1933
Release No. 9689 / December 15, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73840 / December 15, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3981 / December 15, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31374 / December 15, 2014

Admin. Proc. File No. 3-14081

In the Matter of

JOHN P. FLANNERY and
JAMES D. HOPKINS

OPINION OF THE COMMISSION

CEASE-AND-DESIST PROCEEDING

INVESTMENT ADVISER PROCEEDING

INVESTMENT COMPANY PROCEEDING

Grounds for Remedial Action

Antifraud Violations

Respondent, who was a Chief Investment Officer associated with an investment adviser, willfully violated Section 17(a)(3) of the Securities Act of 1933 by engaging in a course of business that operated as a fraud on investors in an unregistered fixed income fund. *Held*, it is in the public interest to suspend Respondent for one year from association with any investment adviser or investment company; to impose a cease-and-desist order; and to assess a $6,500 civil money penalty.

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Respondent, who was a vice president and product engineer associated with an investment adviser, willfully violated Section 17(a)(1) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Exchange Act Rule 10b-5 thereunder by misrepresenting material facts concerning an unregistered fixed income fund. *Held*, it is in the public interest to suspend Respondent for one year from association with any investment adviser or investment company; to impose a cease-and-desist order; and to assess a $65,000 civil money penalty.

APPEARANCES

Mark W. Pearlstein, *Frederic D. Firestone*, and *Laura McLane* of *McDermott Will & Emery LLP*, for John P. Flannery.

John F. Sylvia, *McKenzie E. Webster*, *Jessica C. Sergi*, and *Marbree D. Sullivan* of *Mintz, Levin, Cohn, Ferris, Glovsky and Popeo, P.C.*, for James D. Hopkins.

Deena Bernstein, *Kathleen Shields*, and *Robert Baker*, for the Division of Enforcement.

Appeal filed:	November 21, 2011
Last brief received:	June 13, 2012
Oral Argument:	July 25, 2014

I.

The Division of Enforcement appeals from an administrative law judge's initial decision in this proceeding against Respondents James D. Hopkins and John P. Flannery (collectively, "Respondents"), former employees of State Street Bank and Trust Company ("State Street") and its sister company, State Street Global Advisors ("SSgA").[1] The law judge found that Hopkins and Flannery did not violate the antifraud provisions of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934, and Exchange Act Rule 10b-5 through communications made in connection with the offer and sale of State Street's Limited Duration Bond Fund ("LDBF").[2] We base our findings on an independent review of the record, except with respect to those findings not challenged on appeal.[3]

II.

State Street, a Massachusetts trust company and bank, is a wholly owned subsidiary of State Street Corporation, a publicly held financial services holding company. State Street services and manages assets on behalf of institutional clients. SSgA, which is not itself a legal entity, is the investment management division of State Street Corporation. It provides management and advisory services to State Street-affiliated registered mutual funds, as well as unregistered bank collective trust funds.[4]

LDBF was an unregistered fixed-income fund that was invested in various fixed income products.[5] It was offered and sold only to institutional investors, such as pensions, endowments, charitable trusts, and defined-contribution and defined-benefit plans. From its inception in 2002, LDBF was heavily invested in asset-backed securities ("ABS"), one component of which was residential mortgage-backed securities ("RMBS"). The fund's composition changed continuously over time, and, by 2006 and 2007, it became increasingly concentrated in subprime RMBS. For example, in June 2007, the portfolio was over 80% invested in subprime RMBS.

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1 *John P. Flannery*, Initial Decision Release No. 438, 2011 WL 5130058 (Oct. 28, 2011).

2 15 U.S.C. § 77q(a); *id.* § 78j(b); 17 C.F.R. § 240.10b-5.

3 On June 11, 2013, Respondents filed (and on November 6, 2013, they renewed) a motion to schedule a status conference. Because our Rules of Practice do not provide for such a conference during the pendency of an appeal and we have since held oral argument, we deny Respondents' motion. Further, we note that Rule of Practice 451(d), 17 C.F.R. § 201.451(d), permits a member of the Commission who was not present at oral argument to participate in the decision of the proceeding if that member has reviewed the oral argument transcript prior to such participation. Commissioner Gallagher has made the requisite review.

4 Although State Street and SSgA are technically distinct, the record shows that, throughout the proceeding, they often have been referred to interchangeably. Indeed, as Hopkins testified, both he and Flannery worked for SSgA "as a functional matter," and both were listed on SSgA organizational charts, even though at least Flannery's paycheck was issued by State Street.

5 Technically, LDBF was made up of two unregistered fixed-income funds that followed the same investment strategy. For purposes of this opinion, we treat them as a single fund.

LDBF's use of leverage also increased through 2006 and 2007, which increased the fund's exposure to subprime RMBS.

Investments in LDBF came from a number of sources. First, some other State Street Funds (the "Related Funds") invested directly in LDBF themselves. Second, SSgA provided investment advice to clients through various internal advisory groups; on SSgA's recommendation, clients of those groups invested in LDBF. Finally, a number of independent investors who were not affiliated with either the Related Funds or SSgA's internal advisory groups also invested directly in LDBF.

When the subprime mortgage crisis hit in late July and August of 2007, many—but not all—of LDBF's investors fled the fund. State Street's Related Funds redeemed essentially all of their investments, and several of SSgA's internal advisory groups recommended that their clients seek redemptions, as well. But the other, independent, LDBF investors received no such advice from SSgA, and many of them remained in the fund throughout the Summer of 2007.

From at least 2006 through the subprime mortgage crisis in 2007—the relevant time period for this proceeding—both Flannery and Hopkins were responsible, in part, for communicating with LDBF investors. The Division alleges that the two either made or were responsible for the communications that are the subject of this proceeding.

A. Hopkins

During the relevant period, Hopkins was the Vice President and head of North American Product Engineering at SSgA and a member of SSgA's senior management group. As a product engineer, he served as a liaison between portfolio managers and client-facing personnel, including the sales force and those responsible for client relationships. He was responsible for explaining to the client-facing personnel the strategy and analysis portfolio managers used to manage investment funds.

1. Hopkins's Responsibilities for LDBF's Promotional Materials

Hopkins became LDBF's product engineer in 2005. In this role, he often communicated directly with LDBF investors, participating in presentations to current and prospective investors about LDBF's performance and investment strategy. Hopkins was also responsible for reviewing and ensuring the accuracy of (i) SSgA's "standard PowerPoint slides," which were used in presentations to existing and prospective LDBF investors, and (ii) the information in quarterly fact sheets about LDBF, which were also given to current and prospective investors.

a. Typical Portfolio Slide

SSgA used a standard PowerPoint presentation when presenting information about LDBF or the Related Funds to clients and prospective clients. From September 2006 through June 2007, Hopkins used the standard PowerPoint presentation in numerous meetings with current and prospective investors about LDBF. Either before or at each meeting, the attendees received a copy of the presentation that listed the presenters, including Hopkins, on the front cover.

In 2006 and 2007, the presentation included a slide describing LDBF's "Typical Portfolio Exposures and Characteristics" (the "Typical Portfolio Slide"). This slide presented a breakdown of LDBF's "typical" portfolio by sector, stating, in relevant part, that the fund was only 55% invested in ABS. That breakdown did not change from at least July 2006 through the summer of 2007, even when LDBF's actual investment in ABS far exceeded that depicted in the slide. Because he was responsible for the slides' accuracy, Hopkins was periodically asked by various SSgA and State Street personnel if he wanted to update any of them. He was also required to review the slides for accuracy each quarter. In each instance, Hopkins made no changes to the Typical Portfolio Slide.

In preparation for meetings with investors, Hopkins wrote by hand on his copy of the Typical Portfolio Slide LDBF's *actual* sector allocations—which frequently varied significantly from those listed in the slide.[6] But Hopkins's notes were not distributed to meeting attendees, and there is no evidence that Hopkins otherwise provided accurate information on LDBF's portfolio composition during his presentations.[7] When asked during testimony about his handwritten notes, Hopkins explained that they contained information he *might* present or address, perhaps in response to a question, but he did not necessarily cover the information during any particular presentation.

b. Fact Sheets

The purpose of SSgA's fact sheets, generally, was to inform and provide updates to clients and prospective clients about State Street's funds. LDBF's Fact Sheets, in particular, followed a standard template, which included both a narrative section describing the fund's investment objective, strategy, and risk management, and a data section with statistics on the fund's sector allocation, among other things. As relevant here, the Fact Sheets described LDBF's strategy as "utiliz[ing] an expanded universe of securities that goes beyond typical money markets" and stated that, "[w]hen compared to the typical . . . regulated money market portfolio,

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6 For instance, on July 11, 2006, Hopkins made a presentation to Johns Hopkins University, then a prospective client. On his personal copy of the presentation, Hopkins noted that ABS represented 90% (not 55%) of LDBF's portfolio. On December 18, 2006, Hopkins made a presentation to the consultant Kalson & Associates, noting on his copy of the presentation that LDBF was 80% invested in ABS. On February 13, 2007, Hopkins made a presentation to the Los Angeles County Employees' Retirement Association ("LACERA"), noting on his copy of the presentation that LDBF was 90% invested in ABS.

7 The record is undisputed that at least Johns Hopkins, Kalson, and LACERA did not receive a copy of Hopkins's annotated version of the Typical Portfolio Slide. As to most of the presentations, Hopkins did not recall whether he even discussed the slide or LDBF's portfolio breakdown, and the record does not reflect anyone else's recollection of the meetings. That said, when testifying about the meeting with Johns Hopkins, in particular, Hopkins gave inconsistent, and arguably conflicting, testimony, at one point stating categorically that he "never addressed the[] sector breakdowns" in the slide and "was never asked a question on them," even though he had previously testified that he did not recall whether he used or was asked a question about the Typical Portfolio Slide during the Johns Hopkins presentation.

[LDBF] has better sector diversification." The Fact Sheets also contained a chart disclosing LDBF's "sector weights"—*i.e.*, the percentage of the fund's investments allocated to different market sectors, such as ABS. The Fact Sheets did not include a specific category for subprime RMBS, however; all RMBS investments were included within the ABS category.

2. Hopkins's Communications with LDBF's Investors

In late 2006, home prices began to decline nationally, leading to delinquencies and defaults in the subprime mortgage sector that constituted the bulk of LDBF's assets. As a result, in February 2007, LDBF suffered a serious decline in performance, a significant cause of which was its exposure to the BBB-rated portion of the ABX Home Equity Index (the "ABX Index"), one of the lowest rated tranches of subprime RMBS.[8] The subprime crisis persisted through the Spring and Summer of 2007, as prices continued to fall significantly across even the more highly rated tranches of subprime RMBS. Throughout all of these events, Hopkins played a significant role in communicating with investors and consultants about SSgA's funds' underperformance.

a. March 2007 Letter to Investors

In February 2007, Hopkins was designated as SSgA's point-person to address, generally, its funds' exposure to the BBB-rated tranche of the ABX Index. He drafted an internal memorandum on the subject, which, at the request of client-facing personnel, he converted into a letter to be sent to current and prospective investors and consultants (the "March 2007 letter"). The letter expressly noted that its "purpose" was "not to present an in depth treatise" on recent market events, but rather to discuss those events generally and their effect on SSgA's funds. It explained that SSgA had taken "modest exposure in" BBB-rated investments, "specifically the sub-prime home equity market." It also acknowledged that the price of the BBB-rated tranche had fallen significantly, and, as a result, SSgA's "active portfolios," including LDBF, "underperformed" in February 2007.

b. Presentation to Catholic Healthcare Partners in April 2007

In April 2007, Hopkins gave a presentation to investor Catholic Healthcare Partners about LDBF's losses arising from its exposure to BBB-rated securities. In that meeting, he used a new PowerPoint presentation containing a slide stating, in relevant part, that LDBF's BBB-rated holdings had been "reduced" by one-third (the "ABX Holdings Slide"). Although the slide touted the "reduced" exposure to BBB-rated securities, it omitted to mention that while LDBF's BBB-rated holdings *had* declined from December 2006 to February 2007, those holdings had subsequently *increased*, more than making up for the previous reduction.

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8 The ABX Index tracks price movements of subprime RMBS and is divided into five rating categories (AAA, AA, A, BBB, and BBB-). From January through February 2007, the BBB-rated tranche declined by approximately 18%. During the same period, the AAA- and AA-rated tranches declined by less than 1%.

c. Conference Call with Yanni Partners in April 2007

On April 9, 2007, Hopkins participated in a conference call with representatives from investment consulting firm Yanni Partners (including its chief strategist, David Hammerstein) about State Street's Enhanced Dow Jones-AIG Commodities Index Fund (the "Commodities Fund")—specifically, the fund's exposure to the BBB-rated tranche of the ABX index. Yanni Partners advised several investors in the Commodities Fund, which itself invested in LDBF.

Although Hopkins testified that he did not recall what was said during the call, Hammerstein prepared a memorandum shortly after the call summarizing the discussion. The memorandum noted, in part, that LDBF's "current exposure to the sub-prime issues is now 2%." In testimony, Hammerstein confirmed that he understood from the call that LDBF's *total* subprime RMBS exposure was 2%—and that this exposure was limited to the BBB-rated tranche of the ABX Index. After the call, Yanni Partners recommended that its clients remain in the Commodities Fund.

d. Meeting with National Jewish Medical and Research Center and Yanni Partners on May 10, 2007

On May 10, 2007, Hopkins gave a presentation about LDBF's first-quarter performance to the National Jewish Medical and Research Center, which was a client of Yanni Partners. Before the meeting, National Jewish was given presentation materials that included both the ABX Holdings Slide (stating that LDBF's exposure to the BBB-rated tranche of the ABX Index had been reduced by one-third) and the Typical Portfolio Slide (stating that LDBF's "typical" ABS exposure was 55%).

Hopkins did not recall what he said during the meeting, including whether he discussed either slide. But Hammerstein, who attended the meeting, provided specific testimony about Hopkins's presentation. Hammerstein testified that the presentation lasted for thirty minutes, that Hopkins did most of the talking, and that Hopkins had plenty of time and finished his entire presentation.

With respect to the presentation's content, Hammerstein testified that Hopkins used both the ABX Holdings and the Typical Portfolio slides during the presentation. As to the ABX Holdings Slide, Hammerstein testified that Hopkins both presented the slide and stated that LDBF's total exposure to the BBB-rated tranche of the ABX Index was "about 2 or 3 percent of the total portfolio."[9] Although (according to Hammerstein), Hopkins did not clarify that the "2 or 3 percent" figure reflected an increase in investment level that negated the reduction described in the slide, the figure appears to accurately reflect LDBF's exposure to the BBB-rated tranche of the ABX Index at the time of the meeting.

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9 Meeting minutes prepared by National Jewish also indicate that Hopkins stated that "State Street had just fewer than 3% of BBB subprime investment exposure; 2.5% of that was in BBB ABX."

As for the Typical Portfolio Slide, Hammerstein testified that Hopkins did specifically address the slide. Hammerstein explained that Hopkins used the slide to demonstrate that LDBF "was very high quality" and "very diversified by sector." And Hammerstein understood, from Hopkins's presentation, that LDBF's portfolio was allocated according to the percentages listed in the slide. Hammerstein testified that he found the information on LDBF's sector breakdown important because "[i]t led to the impression that the fund was well diversified, and therefore that State Street took steps to reduce the risks or control the risks." Contrary to the information presented, however, around that time LDBF's actual exposure to ABS was around 100%.[10] Hammerstein further testified that when Yanni Partners ultimately recommended that its clients liquidate their positions in the Commodities Fund, it did so because it felt that SSgA had not "adequately inform[ed] us of the risks in the portfolio, and we cited the example of the presentation that State Street made to National Jewish on May 10 when State Street stated that . . . the typical allocation was 55 percent to the ABS sector, but as recently as March 31 of 2007, the actual ABS allocation was 100 percent."

e. Conference Call with Yanni Partners in July 2007

By July 2007, credit rating agencies had begun to downgrade investments backed by subprime mortgages. And, by the end of the month, those downgrades intensified into a market-wide liquidity crisis; even highly rated tranches of subprime RMBS declined substantially in value. As a result, LDBF experienced another round of significant losses. SSgA held another conference call with Yanni Partners in late July to address the issue; both Hopkins and Hammerstein participated.[11] Hammerstein testified that, before the call, he had understood LDBF to be about 55% invested in ABS, as the Typical Portfolio Slide had represented. He also testified that it was only during the July call that he learned that LDBF's actual ABS exposure was much higher—approaching 100% at one point, with 82% invested in subprime RMBS as of June 30, 2007.

Hammerstein's testimony is supported by a Yanni Partners memorandum (prepared shortly after the July call by a Yanni Partners analyst and edited by Hammerstein) stating that LDBF "was much less diversified than" the May 10 presentation to National Jewish had indicated, and the July call "was the first time" Yanni Partners had "learned that the entire [LDBF] was exposed to the sub-prime market as recently as [March 2007]." This is "remarkable," the memorandum concluded, "given SSgA's presentation to our client on May 10, 2007." The memorandum noted that in "previous discussions," SSgA representatives had "concentrated" on the portion of LDBF's portfolio "invested in BBB sub-prime instruments while

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10 The record shows that, at various times, Hopkins also provided accurate information about LDBF's exposure to ABS (including RMBS) in response to requests from client-facing personnel, investors, and consultants. But there is no evidence that he did so during his presentation to National Jewish. Indeed, Hammerstein's testimony indicates that, during the meeting, Hopkins did *not* correct the information in the Typical Portfolio Slide.

11 The record is not clear as to the exact date of the call, but it appears to have occurred on July 25 or 26.

commenting that the remainder of their portfolio was invested in high quality issues. SSgA never disclosed that those issues were also tied to sub-prime mortgages."[12]

On August 3, 2007, Yanni Partners recommended that all of its clients liquidate their positions in the Commodities Fund. Hammerstein testified that his clients suffered a "peak-to-trough" loss of close to 40% by investing in LDBF through the Commodities Fund.

f. July 26, 2007 Letter to Investors

In early July 2007, Hopkins drafted a memorandum to client-facing personnel about SSgA's active fixed income portfolios, which was subsequently converted into a letter to investors (the "July 26 letter"). Hopkins reviewed for accuracy some of the comments legal counsel made to an early draft, helped coordinate edits by others, and himself commented on a draft.

In its final form, the letter (which Flannery also reviewed and edited) acknowledged that falling prices across "the three ABX Indexes . . . linked to pools of subprime mortgage debt" had contributed to the poor performance of SSgA's "active fixed income portfolios." But it also alluded to *reductions* in SSgA's portfolios' risk profiles, stating: "We have been seeking to reduce risk in those portfolios where we believe it is appropriate by taking advantage of liquidity in the market when it exists, and will continue to do so, while seeking to avoid putting undue pressure on asset valuations."

B. Flannery

During the relevant period, Flannery was the Fixed Income Chief Investment Officer ("CIO") for the Americas at SSgA. He reported directly to SSgA's President and CEO. SSgA's portfolio managers (including the manager responsible for LDBF) reported indirectly to Flannery.

1. July 25, 2007 Investment Committee Meeting, Asset Liquidation, and Investor Redemptions

As noted above, the subprime crisis deepened significantly in July 2007, and prices fell not only in the BBB-rated tranche of the ABX Index, but also in the AAA- and AA-rated tranches. SSgA anticipated that, as a result, many investors would seek redemptions from LDBF. SSgA's Investment Committee, which had ultimate authority over all SSgA investments, addressed the issue at its July 25, 2007 meeting.

Draft meeting minutes reveal that Flannery, who filled in as the chair for the meeting (as the regular chairman was unable to attend), framed the discussion by explaining that the primary

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12 Minutes from a Yanni Partners Investment Policy Committee meeting held on August 2, 2007 similarly state that the "typical" sector breakdown presented by SSgA "suggest[ed] a much more diversified strategy than was actually being employed."

issue the committee faced was how "to provide liquidity if our clients want to leave the fund."[13] He estimated that the additional liquidity would be required by the end of July. And, in his view, it could be raised in one of two ways: (i) sell LDBF's AAA-rated bonds, its most liquid assets, or (ii) sell a pro-rata share of assets across the portfolio. But, Flannery warned, if the committee followed the first approach and redemptions occurred (as expected), LDBF would be "stuck with a lower quality portfolio" that was "less liquid" and "valued less." He therefore endorsed the second approach. In contrast, Robert Pickett, LDBF's portfolio manager, advocated the first approach, noting that the AA-rated securities were "very illiquid" as compared to the AAA-rated ones. But, Pickett acknowledged, selling just the AAA-rated securities would "change [LDBF's] risk profile."

Numerous other attendees also remarked about the effect that liquidating just the AAA-rated bonds (versus selling a pro-rata share of assets) would have on LDBF's risk profile. One observed that anticipated redemptions would leave LDBF with just the "illiquid" and "riskier" AA-rated investments. Another asked whether selling just the AAA-rated bonds would "expos[e]" committee members "to fiduciary risk since [they] are changing the risk profile of [LDBF's] portfolio"—to which an attendee responded that if no redemptions occurred, "then no; but if a client withdraws [they] will need to revalue the portfolio." And yet another attendee hypothesized a "[w]orse [sic] case scenario" in which SSgA's own (Related) funds exited LDBF and remaining "clients in the fund . . . suffer."

Ultimately, the committee decided upon an approach between those recommended by Flannery and Pickett, instructing the portfolio management team first to build 30 to 40% liquidity in LDBF by the end of July (within less than a week); then, if redemptions occurred, to sell a pro-rata share of the fund's assets to satisfy additional demand for liquidity. But any redemptions would be first-come, first-served.

On July 26 and 27, the portfolio management team sold from LDBF approximately $1.6 billion in AAA-rated bonds and about $200 million in AA-rated bonds. By August 2, all but between $175 million and $195 million of the proceeds had been used for investor redemptions and to repay repurchase commitments. As a result of these transactions, from July 26 to August 2, LDBF's portfolio composition changed from approximately 48% invested in AAA-rated securities to less than 5%, and from approximately 46% invested in AA-rated securities to over 80%.

Russell Wermers, an expert witness for the Division, testified that LDBF's risk profile increased across that period. He explained that the liquidation of AAA-rated bonds temporarily brought more liquidity—and therefore less risk—to LDBF. But, as the cash from the sales "was largely gone within a few days" to pay redeeming investors, LDBF "became more risky almost immediately, because it had sold its highest-rated and most-liquid securities, and what remained was riskier, illiquid securities."[14] Respondents' expert witness, Ezra Zask, opined that the July

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13 Flannery testified that these draft meeting minutes are a reasonably accurate reflection of what occurred. The final meeting minutes omitted much of the detail contained in the draft.

14 Pickett concurred with Wermers, testifying that, if the cash from the sale of the AAA-rated bonds were used to meet redemptions, then LDBF's risk level would increase.

26 and 27 transactions *reduced* LDBF's risk profile because cash is less risky than AAA-rated bonds. But Zask did not address the effect on LDBF's risk profile of using the cash to pay investor redemptions.

2. August 2, 2007 Letter to Investors

In late July 2007, as SSgA was liquidating AAA-rated bonds, its executives began drafting a new letter to investors about the effects of the subprime mortgage crisis on "SSgA's active fixed income and active derivative-based strategies," including LDBF (the "August 2 letter"). After receiving an early draft, Flannery edited the letter's last paragraph, which addressed the funds' risk profiles.[15] In its final form, that paragraph stated:

> [T]he downdraft in valuations has had a significant impact on the risk profile of our portfolios, prompting us to take steps to seek to reduce risk across the affected portfolios. To date, in the Limited Duration Bond Strategy, we have reduced a significant portion of our BBB-rated securities and we have sold a significant amount of our AAA-rated cash positions. Additionally, AAA-rated exposure has been reduced as some total return swaps rolled off at month end. Throughout this period, the Strategy has maintained and continues to be AA in average credit quality according to SSgA's internal portfolio analytics. The actions we have taken to date in the Limited Duration Bond Strategy simultaneously reduced risk in other SSgA active fixed income and active derivative-based strategies.

3. August 14, 2007 Letter to Investors

In early August, Flannery drafted (and ultimately signed) another investor letter addressing LDBF's continued poor performance (the "August 14 letter"). Given the magnitude of the challenges facing LDBF, Flannery believed that investors should hear directly from SSgA's CIO. His initial draft stated, in pertinent part:

> While we believe that the subprime markets clearly convey far greater risk than they have historically we feel that forced selling in this chaotic and illiquid market is unwise. . . . [W]e believe that liquidity will slowly re-enter the market and the segment will regain its footing. While we will continue to liquidate assets for our clients when they demand it, our advice is to hold the positions for now.

Flannery's draft was reviewed by in-house and outside counsel. In its final form, the letter contained an edit from in-house attorney Mark Duggan, who changed the final sentence quoted above to read: "While we will continue to liquidate assets for our clients when they demand it, we believe that many judicious investors will hold the positions in anticipation of greater liquidity in the months to come." Flannery did not object to the change, he explained, as he believed the revised language was accurate and did not alter the recommendation in his draft that investors should remain in LDBF.

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15 Flannery also reviewed a subsequent version of the letter before it was sent on August 2. Other senior SSgA personnel and legal counsel also reviewed and edited the letter.

III.

The Division alleges that through the conduct described above, Hopkins and Flannery violated Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, as well as Section 17(a) of the Securities Act. Before turning to the Division's particular allegations, we explain our understanding of those provisions, including our reasons for rejecting the interpretations Hopkins and Flannery advance. We find it important to do so now for several reasons.

Notwithstanding intermittent guidance from the Supreme Court, lower courts have adopted varying approaches to liability under Rule 10b-5 (which implements Section 10(b)) and Section 17(a). The Supreme Court's recent decision in *Janus Capital Group v. First Derivative Traders* resolved some of the differences among the lower courts, as it clarified—and limited—the scope of liability under Rule 10b-5(b).[16] The decision was silent, however, as to Rule 10b-5(a) and (c) and Section 17(a), creating confusion in the lower courts as to whether its limitations apply to those provisions, as well. Moreover, *Janus*'s narrowing of liability under Rule 10b-5(b) has shifted attention to Rule 10b-5(a) and (c), as well as Section 17(a), making the lower courts' divergence of views on the scope of those provisions especially evident.[17]

We appreciate the challenges lower courts have faced, and we recognize the ambiguity in Section 10(b), Rule 10b-5, and Section 17(a). Further, we note that, to date, Commission opinions have provided relatively little interpretive guidance regarding the meaning and interrelationship of these provisions. By setting out our interpretation of these provisions—which is informed by our experience and expertise in administering the securities laws—we intend to resolve the ambiguities in the meaning of Rule 10b-5 and Section 17(a) that have produced confusion in the courts and inconsistencies across jurisdictions.

Although we also look to the history and policies of the provisions at issue, our analysis begins with the text. Section 10(b) makes it "unlawful for any person directly or indirectly . . . to use or employ, in connection with the purchase or sale of any security . . . any manipulative or deceptive device or contrivance in contravention of" Commission rules.[18] Rule 10b-5 implements the Commission's authority under Section 10(b).[19] It does so through three

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16 131 S. Ct. 2296 (2011).

17 *Compare, e.g.*, *IBEW Local 90 Pension Fund v. Deutsche Bank AG*, No. 11-4209, 2013 WL 1223844, at *1 (S.D.N.Y. Mar. 27, 2013) (stating that "a series of alleged misstatements" that would be "separately actionable" under Rule 10b-5(b) may also be charged as a "course of conduct" amounting to a "fraudulent scheme" in violation of Rule 10b-5(a) or (c)) *with SEC v. Langford*, No. 8:12CV344, 2013 WL 1943484, at *8 (D. Neb. May 9, 2013) (stating that Rule 10b-5(a) and (c) may be used only to charge conduct that is "beyond" or "distinct from" any "alleged misrepresentation or omission") *and SEC v. Kelly*, 817 F. Supp. 2d 340, 345 (S.D.N.Y. 2010) (stating that, in misstatement cases, as long as the defendant did not "make" the misstatement, even conduct "beyond" the misstatement cannot be charged under Rule 10b-5(a) or (c)).

18 15 U.S.C. § 78j(b).

19 *See United States v. Zandford*, 535 U.S. 813, 816 n.1 (2002).

subsections that are, as we have explained, "mutually supporting rather than mutually exclusive."[20] Rule 10b-5(a) prohibits "directly or indirectly . . . employ[ing] any device, scheme, or artifice to defraud."[21] Rule 10b-5(b) prohibits "directly or indirectly . . . mak[ing] any untrue statement of a material fact or [omitting] to state a material fact necessary in order to make the statements made . . . not misleading."[22] And Rule 10b-5(c) prohibits "directly or indirectly . . . engag[ing] in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person."[23] Liability under all three subsections requires a showing of scienter.[24]

Section 17(a) makes it unlawful to engage in certain conduct "directly or indirectly" in "the offer or sale of securities."[25] Like Rule 10b-5, Section 17(a) expresses its prohibitions in three "mutually supporting" subsections.[26] Section 17(a)(1) prohibits "employ[ing] any device, scheme, or artifice to defraud."[27] Section 17(a)(2) prohibits "obtain[ing] money or property by means of any untrue statement of a material fact or any [material] omission."[28] And Section 17(a)(3) prohibits "engag[ing] in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."[29] A showing of scienter is required

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20 *Cady, Roberts & Co.*, Exchange Act Release No. 6668, 40 SEC 907, 1961 WL 60638, at *4 (Nov. 8, 1961).

21 17 C.F.R. § 240.10b-5(a).

22 *Id.* § 240.10b-5(b).

23 *Id.* § 240.10b-5(c).

24 *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 194, 213 (1976). Scienter is an "intent to deceive, manipulate, or defraud." *Id.* at 193 & n.12. It may be established through a heightened showing of recklessness. *Rockies Fund, Inc. v. SEC*, 428 F.3d 1088, 1093 (D.C. Cir. 2005); *SEC v. Ficken*, 546 F.3d 45, 47 (1st Cir. 2008); *see also Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 319 n.3 (2007) (noting that "[e]very Court of Appeals that has considered the issue has held that a plaintiff may meet the scienter requirement by showing that the defendant acted intentionally or recklessly" but that standards vary). "Extreme recklessness is an 'extreme departure from the standards of ordinary care, . . . which presents a danger of misleading buyers or sellers that is either known to the defendant or is so obvious that the actor must have been aware of it.'" *Rockies Fund*, 428 F.3d at 1093 (quoting *SEC v. Steadman*, 967 F.2d 636, 641 (D.C. Cir. 1992)); *accord Ficken*, 546 F.3d at 47-48.

25 15 U.S.C. § 77q(a).

26 *Cady, Roberts & Co.*, 1961 WL 60638, at *4.

27 15 U.S.C. § 77q(a)(1).

28 *Id.* § 77q(a)(2).

29 *Id.* § 77q(a)(3).

under Section 17(a)(1), but a showing of negligence suffices under subsections (a)(2) and (a)(3).[30]

A. Primary Liability Under Rule 10b-5(b) and Section 17(a)(2)

Rule 10b-5(b) and Section 17(a)(2) both specifically address liability for false statements and omissions.[31] In *Janus*, the Supreme Court interpreted Rule 10b-5(b)'s prohibition against "mak[ing] any untrue statement of a material fact."[32] After concluding that liability could extend only to those with "ultimate authority" over an alleged false statement, the Court held that an investment adviser who drafted misstatements that were later included in a separate mutual fund's prospectus could not be held liable under Rule 10b-5(b).[33] The adviser could not be said to have "made" the misstatements, the Court reasoned, because it was the mutual fund, not the adviser, who actually filed the prospectus.[34] The Second Circuit, one of the few appellate courts to consider *Janus*'s "ultimate authority" standard to date, has held that liability under Rule 10b-5(b) extends to defendants who "retain[] ultimate control over both the content of the communication and the decision" to communicate it, even if others are "responsible for the act of communication."[35]

Unlike Rule 10b-5(b), liability under Section 17(a)(2) is not contingent on whether one has "made" a false statement. Under Section 17(a)(2), liability instead turns on whether one has obtained money or property "by means of" an untrue statement.[36] We, like a number of courts,

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30 *Aaron v. SEC*, 446 U.S. 680, 697 (1980). Negligence requires a showing that the defendant failed to exercise reasonable care. *Ira Weiss*, Exchange Act Release No. 52875, 58 SEC 977, 2005 WL 3273381, at *12 (Dec. 2, 2005) (citing *SEC v. Hughes Capital Corp.*, 124 F.3d 449, 453-54 (3d Cir. 1997)), *pet. denied*, *Weiss v. SEC*, 468 F.3d 849 (D.C. Cir. 2006). As many courts have recognized, the Supreme Court's decision in *Aaron* makes clear that negligence is sufficient to establish liability under Section 17(a)(2) and (a)(3). *E.g.*, *Ficken*, 546 F.3d at 47; *Weiss*, 468 F.3d at 855. But the Court has never addressed whether negligence is *necessary* to prove a violation of those provisions. Indeed, *Aaron* itself suggests that, at least under Section 17(a)(3), the focus is only on the "*effect* of particular conduct on members of the investing public, rather than upon the culpability of the person responsible" for the conduct. 446 U.S. at 696-97 (emphasis in original).

31 Throughout this opinion, we use the terms "misstatement" and "misrepresentation" to encompass both affirmatively false statements and misleading omissions.

32 *Janus*, 131 S. Ct. at 2302.

33 *Id.* at 2302-05.

34 *Id.* at 2305.

35 *SEC v. Pentagon Capital Mgmt.*, 725 F.3d 279, 285-86 (2d Cir. 2013), *cert. denied*, 2014 WL 2921728 (U.S. June 30, 2014) (affirming liability under Rule 10b-5(b) for late-trading scheme where defendants directed the entry of trades using trade sheets containing misleading time-stamps, but the actual trades were executed by a broker).

36 15 U.S.C. § 77q(a)(2).

find these textual differences significant and conclude that, at least in this respect, Section 17(a)(2) "covers a broader range of activity" than Rule 10b-5(b).[37] In particular, like the First Circuit, we interpret Section 17(a)(2)'s "by means of" requirement to mean that a defendant may be held primarily liable if he *uses* a misstatement to obtain money or property, even if he "has not himself made a false statement in connection with the offer or sale of a security."[38]

Further, we conclude that because the word "make," is "absent from the operative language" of Section 17(a)(2), *Janus*'s limitation on primary liability under Rule 10b-5(b) does not apply to claims arising under Section 17(a)(2).[39] The vast majority of lower courts to consider the issue agree, reasoning that *Janus*'s holding "may not be extended to statutes lacking the very language that *Janus* construed."[40] Indeed, as one court observed, the Supreme Court's emphasis on the text of Rule 10b-5(b) "serves, if anything, to highlight the importance of the difference in the language between the two provisions."[41]

Finally, we note that our reading of Section 17(a)(2) is strongly supported by our consideration of relevant policy objectives. To be sure, it might reduce the complexity of our enforcement actions to construe Rule 10b-5(b) and Section 17(a)(2) to encompass identical conduct (apart from Rule 10b-5(b)'s scienter requirement) and to read *Janus* to apply equally to both provisions. But such an approach would conflict with the remedial purposes of the Securities Act, as well as our long-held position that the securities laws "should not be construed

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37 *See, e.g.*, *SEC v. Stoker*, 865 F. Supp. 2d 457, 464-66 (S.D.N.Y. 2012); *see also SEC v. Tambone*, 550 F.3d 106, 127-28 (1st Cir. 2008), *opinion withdrawn*, 573 F.3d 54 (1st Cir. 2009), *reinstated in relevant part*, 597 F.3d 436 (1st Cir. 2010) (en banc).

38 *Tambone*, 550 F.3d at 127-28 ("Liability attaches so long as the statement is *used* 'to obtain money or property,' regardless of its source." (emphasis in original)); *Stoker*, 865 F. Supp. 2d at 465 (a defendant "may be held liable under 17(a)(2)" if "he obtains money or property *by use* of a false statement, whether prepared by himself or by another" (emphasis in original)).

39 *See SEC v. Daifotis*, No. C11-00137 WHA, 2011 WL 3295139, at *5 (N.D. Cal. Aug. 1, 2011); *see also Stoker*, 865 F. Supp. 2d at 464-66 & n.8 (collecting cases limiting *Janus*'s holding to Rule 10b-5(b) and criticizing the reasoning of the Initial Decision in its application of *Janus* to the Commission's Section 17(a) claims).

40 *SEC v. Mercury Interactive LLC*, No. 5:07-cv-02822-WHA, 2011 WL 5871020, at *3 (N.D. Cal. Nov. 22, 2011); *accord SEC v. Monterosso*, 756 F.3d 1326, 1334 (11th Cir. 2014); *SEC v. Garber*, 959 F. Supp. 2d 374, 2013 WL 1732571, at *4 (S.D.N.Y. 2013); *Stoker*, 865 F. Supp. 2d at 464-66; *SEC v. Sells*, No. C 11-4941 CW, 2012 WL 3242551, at *7 (N.D. Cal. Aug. 10, 2012); *SEC v. Sentinel Mgmt. Group, Inc.*, No. 07 C 4684, 2012 WL 1079961, at *14-15 (N.D. Ill. Mar. 30, 2012); *SEC v. Radius Capital Corp.*, No. 2:11-cv-116-FtM-29DNF, 2012 WL 695668, at *4 n.7 (M.D. Fla. Mar. 1, 2012); *Daifotis*, 2011 WL 3295139, at *5. *But see Kelly*, 817 F. Supp. 2d at 345 (applying *Janus* to claims brought under Section 17(a) on the theory that "[a]lthough the language of [Section 17(a)(2)] is not identical to that of [Rule 10b-5(b)], both provisions have the same functional meaning").

41 *Stoker*, 865 F. Supp. 2d at 465.

technically and restrictively, but flexibly to effectuate [those] remedial purposes."[42] Were we to construe Section 17(a)(2) more narrowly—as at least one district court has done[43]—it would eliminate even the possibility of liability under that provision for individuals who plainly use or employ, but are not themselves the "makers" of, material misstatements that defraud investors. We cannot endorse such a result.

B. Primary Liability Under Rule 10b-5(a) and (c)

1. Rule 10b-5(a) and (c) proscribe employing any manipulative or deceptive device or engaging in any manipulative or deceptive act, including the drafting or devising of fraudulent misstatements.

Unlike Rule 10b-5(b), Rule 10b-5(a) and (c) do not address only fraudulent misstatements. Rule 10b-5(a) prohibits the use of "*any* device, scheme, or artifice to defraud," while Rule 10b-5(c) prohibits "engag[ing] in *any* act, practice, or course of business which operates or would operate as a fraud or deceit."[44] The very terms of the provisions "provide a broad linguistic frame within which a large number of practices may fit."[45] We have explained that Rule 10b-5 is "designed to encompass the infinite variety of devices that are alien to the climate of fair dealing . . . that Congress sought to create and maintain."[46] The Supreme Court, too, has recognized that Section 10(b) and Rule 10b-5 "are broad and, by repeated use of the word 'any' are obviously meant to be inclusive."[47] The Court also has noted that the provisions "must be read flexibly, not technically or restrictively" in order to achieve the remedial purposes of Section 10(b) and Rule 10b-5.[48]

Nonetheless, liability under Rule 10b-5 cannot "extend beyond conduct encompassed by Section 10(b)'s prohibition."[49] And Section 10(b)'s prohibition encompasses only acts that are

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42 *E.g.*, *John Kilpatrick*, Exchange Act Release No. 23251, 48 SEC 481, 1986 WL 626187, at *5 (May 19, 1986) (citing *Tcherepnin v. Knight*, 389 U.S. 332, 336 (1967); *Affiliated Ute Citizens of the State of Utah v. United States*, 406 U.S. 128, 151 (1972); and *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963)).

43 *Kelly*, 817 F. Supp. 2d at 345.

44 17 C.F.R. § 240.10b-5(a), (c) (emphasis added).

45 *SEC v. Clark*, 915 F.2d 439, 448 (9th Cir. 1990) (noting the breadth of the terms "'fraud,' 'deceit,' and 'device, scheme, or artifice'").

46 *Collins Sec. Corp.*, 46 SEC 20, 33 (1975) (internal quotation marks omitted).

47 *Affiliated Ute*, 406 U.S. at 151.

48 *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 475-76 (1977); *Affiliated Ute*, 406 U.S. at 151.

49 *United States v. O'Hagan*, 521 U.S. 642, 651 (1997) (citing *Hochfelder*, 425 U.S. at 214, and *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 511 U.S. 164, 173 (1994)).

"themselves manipulative or deceptive."[50] Accordingly, only conduct that is itself manipulative or deceptive violates Rule 10b-5.[51]

Respondents contend that Rule 10b-5(a) and (c) are subject to additional limitations. We disagree. Rather, we conclude that primary liability under Rule 10b-5(a) and (c) extends to one who (with scienter, and in connection with the purchase or sale of securities) employs *any* manipulative or deceptive device or engages in *any* manipulative or deceptive act.[52] As various courts have recognized, that standard certainly would encompass the falsification of financial records to misstate a company's performance,[53] as well as the orchestration of sham transactions designed to give the false appearance of business operations.[54] As one court explained, those

[50] *Central Bank*, 511 U.S. at 177-78; *accord Santa Fe*, 430 U.S. at 473; *Hochfelder*, 425 U.S. at 214.

[51] *See Robert W. Armstrong, III*, Exchange Act Release No. 51920, 58 SEC 542, 2005 WL 1498425, at *6 (June 24, 2005); *Leslie A. Arouh*, Exchange Act Release No. 50889, 57 SEC 1099, 2004 WL 2964652, at *5 (Dec. 20, 2004).

[52] Of course, the meaning of the terms "manipulative" and "deceptive" is not self-evident. "Manipulative," the Supreme Court has explained, is "a term of art when used in connection with securities markets," referring to practices "such as wash sales, matched orders, or rigged prices, that are intended to mislead investors by artificially affecting market activity." *Sante Fe*, 430 U.S. 462, 476 (1977). The Court has not made a similar pronouncement on the meaning of "deceptive," though other courts have held that the term encompasses "a wide spectrum of conduct involving cheating or trading in falsehoods." *SEC v. Dorozkho*, 574 F.3d 42, 50 (2d Cir. 2009). Those courts have relied on dictionaries in use at the time Congress passed the Exchange Act that define "deceptive" as "having power to mislead" or "[t]ending to deceive," and define "deceive" as "[t]o cause to believe the false or to disbelieve the true." *Id.*; Webster's International Dictionary 679 (2d ed. 1934); *see also Hochfelder*, 425 U.S. at 199 nn. 20, 21 (consulting the 1934 edition of Webster's International Dictionary to define other terms in Section 10(b)). In light of these precedents and the definitions on which they rely, we conclude that to employ a "deceptive" device or to commit a "deceptive" act is to engage in conduct that gives rise to a false appearance of fact.

[53] *E.g.*, *Monterosso*, 756 F.3d at 1334-36 (holding that falsification of financial records can suffice for primary liability under Rule 10b-5(a)); *SEC v. Familant*, 910 F. Supp. 2d 83, 86-88, 93-97 (D.D.C. 2012) (agreeing that such conduct suffices for primary liability under both Rule 10b-5(a) and (c)); *Langford*, 2013 WL 1943484, at *8 (same); *Sells*, 2012 WL 3242551, at *6-7 (same); *Mercury Interactive*, 2011 WL 5871020, at *2 (same).

[54] *E.g.*, *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 504 (S.D.N.Y. 2005) (holding that banks could be liable under Rule 10b-5(a) and (c) for engaging in transactions with issuer that lacked economic substance and allowed the issuer to misstate its financial condition); *In re Global Crossing Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 336-37 (S.D.N.Y. 2004) (holding that auditor could be liable under Rule 10b-5(a) and (c) for masterminding sham swap transactions that were used to circumvent GAAP and inflate and misstate company's revenue); *In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp. 2d 161, 173-74 (D. Mass. 2003) (holding that companies that created and financed sham entities that entered into bogus transactions with another company to

(continued...)

who engage in such conduct are independently liable for their own deceptive acts, "even if a material misstatement by another person creates the nexus between the scheme and the securities market."[55]

But we believe that primary liability under Rule 10b-5(a) and (c) extends even further than many of those courts have suggested.[56] In particular, we conclude that primary liability under Rule 10b-5(a) and (c) *also* encompasses the "making" of a fraudulent misstatement to investors, as well as the drafting or devising of such a misstatement. Such conduct, in our view, plainly constitutes employment of a deceptive "device" or "act."[57] Indeed, the Supreme Court recently indicated that it agreed with this understanding—at least to the extent that Rule 10b-5(a) encompasses the "making" of a material misrepresentation.[58]

We note that, contrary to what some district courts have suggested,[59] *Janus* does not require a different result. In *Janus*, the Court construed only the term "make" in Rule 10b-5(b), which does not appear in subsections (a) and (c); the decision did not even mention, let alone construe, the broader text of those provisions.[60] And the Court never suggested that because the "maker" of a false statement is primarily liable under subsection (b), he cannot *also* be liable under subsections (a) and (c). Nor did the Court indicate that a defendant's failure to "make" a

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(...continued)
inflate and misstate that company's profits could be liable under Rule 10b-5(a) and (c)). These examples of deceptive acts are not exclusive. For instance, a defendant who does not "make" a misstatement for purposes of Rule 10b-5(b), but who does breach a fiduciary duty in furtherance of a fraud—perhaps by concealing the fraud from the company's board of directors—may be liable under Rule 10b-5(a) and (c) if the breach involved deception. *Cf.*, *Ryan v. Gifford*, 935 A.2d 258, 272 (Del. Ch. 2007) (concealment of a fraud from shareholders is a "deception" in breach of a fiduciary duty).

55 *Parmalat*, 376 F. Supp. 2d at 502; *see also Monterosso*, 756 F.3d at 1334-36.

56 *E.g.*, *Familant*, 910 F. Supp. 2d at 97 (suggesting that Rule 10b-5(a) and (c) are limited to conduct "beyond mere misstatements and omissions").

57 17 C.F.R. § 240.10b-5(a), (c).

58 *Chadbourne & Parke LLP v. Troice*, 134 S. Ct. 1058, 1063 (2014) (stating that Rule 10b-5 "forbids the use of any 'device, scheme, or artifice to defraud' (*including* the making of 'any untrue statement of a material fact' or any similar 'omi[ssion]') 'in connection with the purchase or sale of any security'" (alterations in original; emphasis added)).

59 *E.g.*, *SEC v. Benger*, No. 09 C 676, 2013 WL 1150587, at *5 (N.D. Ill. Mar. 21, 2013) ("*Janus* cannot be skirted simply by artful pleading and rechristening a 10b-5(b) claim as a claim under 10b-5(a) and (c)."). *But see, e.g.*, *Monterosso*, 756 F.3d at 1334 (stating that "*Janus* only discussed what it means to 'make' a statement for purposes of Rule 10b–5(b), and did not concern . . . Rule 10b–5(a) or (c)"); Arnold S. Jacobs, *Disclosure and Remedies under the Securities Laws* § 12:113.99 (agreeing that *Janus* "does not control any suit under" Rule 10b-5(a) or (c)).

60 *See generally Janus*, 131 S. Ct. 2296.

misstatement for purposes of subsection (b) precludes primary liability under the other provisions.

Moreover, our approach is fully consistent with the rationales on which *Janus* rests. The Court began its analysis with a textual basis for its holding, concluding that one who merely "prepares" a statement necessarily is not its "maker," just as a mere speechwriter lacks "ultimate authority" over the contents of a speech.[61] Our approach does not conflict with that logic: Accepting that a drafter is not primarily liable for "making" a misstatement under Rule 10b-5*(b)*, our position is that the drafter would be primarily liable under subsections *(a)* and *(c)* for employing a deceptive "device" and engaging in a deceptive "act."

Our approach is also consistent with the Court's second justification for its holding—that a drafter's conduct is too remote to satisfy the element of reliance in private actions arising under Rule 10b-5. Investors, the Court explained, cannot be said to have relied on "undisclosed act[s]," such as merely drafting a misstatement, that "preced[e] the decision of an independent entity to make a public statement."[62] Again, our analysis fully comports with that logic. Indeed, we do not suggest that the outcome in *Janus* itself might have been different if only the plaintiffs' claims had arisen under Rule 10b-5(a) or (c). As *Janus* recognizes, those plaintiffs may not have been able to show reliance on the drafters' conduct, regardless of the subsection of Rule 10b-5 alleged to have been violated. Thus, our interpretation would not expand the "narrow scope" the Supreme Court "give[s to] the implied private right of action."[63]

But to say that a claim will not succeed in every case is not to say that there is no claim at all. In contrast to private parties, the Commission need not show reliance as an element of its claims.[64] Thus, even if *Janus* precludes private actions against those who commit "undisclosed" deceptive acts, it does not preclude Commission enforcement actions under Rule 10b-5(a) and (c) against those same individuals.

2. Rule 10b-5 is not subject to the limitations Hopkins and Flannery suggest.

Hopkins and Flannery contend that, where a fraud is ultimately effected through misstatements, if the defendant did not himself "make" those misstatements, then primary liability under Rule 10b-5(a) and (c) can be established only through a showing of "additional" deceptive conduct "apart from" the misstatements. Respondents rely, in part, on *SEC v. Kelly*, a district court case that itself proposes an even narrower window for primary liability under Rule 10b-5(a) and (c). The court suggested that whenever a fraud involves misstatements made by someone other than the defendant, the defendant can *never* be held liable under Rule 10b-5(a) or

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61 *Id.* at 2302.

62 *Id.* at 2303-04 (citing *Stoneridge Inv. Partners v. Scientific-Atlanta, Inc.*, 552 U.S. 148, 161 (2008)).

63 *Id.* at 2303.

64 *See, e.g.*, *SEC v. Morgan Keegan & Co.*, 678 F.3d 1233, 1244 (11th Cir. 2012) (noting that reliance is not an element of a Commission enforcement action).

(c), regardless of whether he engaged in deceptive conduct distinct from the misstatements.[65] We reject both constructions of our rule.

To begin with, neither reading of Rule 10b-5 can be reconciled with the text of the rule. As previously noted, Rule 10b-5(a) proscribes deceptive "device[s]," "scheme[s]," and "artifice[s] to defraud," and Rule 10b-5(c) proscribes, among other things, deceptive "act[s]." It would require a wholly arbitrary reading of those terms to construe them as *excluding* the making, drafting, or devising of a misstatement. And, as noted, the Supreme Court has recently indicated that it, too, would reject such a narrow reading of subsections (a) and (c).[66]

What is more, we have never suggested that the subsections of Rule 10b-5 must be read exclusively, such that conduct that falls within the purview of one—*e.g.*, misstatements, within subsection (b)—cannot also fall within another. To the contrary, we have explicitly advised that we consider the subsections of the rule "mutually supporting rather than mutually exclusive."[67] And, as discussed above, we have repeatedly emphasized our policy of construing the securities laws—and the rules promulgated thereunder—broadly and "flexibly[,] to effectuate [their] remedial purposes," rather than "technically and restrictively."[68] Reading the subsections of Rule 10b-5 to overlap, as we do, ensures that the Division has appropriate flexibility to charge—and protect investors from—manipulative and deceptive conduct in connection with the purchase or sale of securities.

Several courts *have* adopted the "beyond-a-misstatement" approach that Hopkins and Flannery propose, effectively holding that any misstatement-related conduct is exclusively the province of subsection (b).[69] For multiple reasons, we disagree with those decisions. First, as

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65 *See Kelly*, 817 F. Supp. 2d at 344.

66 *See Troice*, 134 S. Ct. at 1063.

67 *Cady, Roberts & Co.*, 1961 WL 60638, at *4. And in *Capital Gains*, the Supreme Court explained that because the Securities Act of 1933 was "the first experiment in federal regulation of the securities industry," it "was understandable" that Congress "include[d] both a general proscription against fraudulent and deceptive practices and, out of an abundance of caution, a specific proscription against nondisclosure." 375 U.S. at 197-98. Because Rule 10b-5 was modeled on Section 17(a) of the Securities Act, we find the same logic applicable to Rule 10b-5. It is thus reasonable to construe Rule l0b-5(a) and (c) as encompassing "all acts within the purview of Rule 10b-5[(b)]." *See* Jacobs, *Disclosure and Remedies under the Securities Laws* § 6:22 (citing *Capital Gains*); *Troice*, 134 S. Ct. at 1063.

68 *Kilpatrick*, 1986 WL 626187, at *5; *see also Rita J. McConville*, Exchange Act Release No. 51950, 58 SEC 596, 2005 WL 1560276, at *13 (June 30, 2005) ("The securities laws are to be construed broadly to effectuate their remedial purpose."), *pet. denied*, 465 F.3d 780 (7th Cir. 2006).

69 *See, e.g.*, *WPP Luxembourg Gamma Three Sarl v. Spot Runner, Inc.*, 655 F.3d 1039, 1057-58 (9th Cir. 2011) (collecting cases); *Public Pension Fund Grp. v. KV Pharm. Co.*, 679 F.3d 972, 987 (8th Cir. 2012) (following *WPP Luxembourg*); *Lentell v. Merrill Lynch & Co.*, 396 F.3d 161, 177-78 (2d Cir. 2005) (applying similar rule).

noted above, their conclusion contravenes the plain text of the rule. In addition, we understand their approach to have arisen from a misunderstanding of the Supreme Court's decision in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver*. In *Central Bank*, the Court explained that only defendants who themselves employ a manipulative or deceptive device or make a material misstatement may be primarily liable under Rule 10b-5; others are, at most, secondarily liable as aiders and abettors.[70] Lower courts appropriately read *Central Bank* to require that, in cases involving fraudulent misstatements, defendants could not be primarily liable under Rule 10b-5(a) or (c) merely for having "assisted" an alleged scheme to make a fraudulent misstatement.[71] But they then began to articulate this "more-than-mere-assistance" standard imprecisely, stating that primary liability under Rule 10b-5(a) and (c) must require proof of particular deceptive conduct "beyond" the alleged misstatements.[72]

We cannot agree with this construction of our rule, particularly given how far removed it is from its origins in *Central Bank*. And *Central Bank* itself certainly does not hold that primary liability under Rule 10b-5(a) and (c) turns on whether a defendant's conduct is "beyond" a misstatement.[73] Moreover, we note that *Janus* also does not independently justify such a test. As discussed, *Janus* does not address Rule 10b-5(a) or (c), let alone suggest that primary liability under those provisions is limited to deceptive acts "beyond" misstatements. Indeed, reading *Janus* to require such an approach would be inconsistent with the decision's own emphasis on adhering to the text of the rule.[74]

Having rejected the "beyond a misstatement" approach, we necessarily also reject the even more untenable reading of Rule 10b-5(a) and (c) adopted in *Kelly*.[75] The court in that case

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70 511 U.S. at 191.

71 *E.g., Parmalat*, 376 F. Supp. 2d at 503 (explaining that Rule 10b-5(a) and (c) are violated if the "defendant's challenged conduct in relation to [the] fraudulent scheme constitutes the use of a deceptive device or contrivance"); *Lernout & Hauspie*, 236 F. Supp. 2d at 173-74.

72 *E.g., In re Alstom SA*, 406 F. Supp. 2d 433, 475-76 (S.D.N.Y. 2005).

73 We believe that our approach appropriately distinguishes between primary and secondary liability, as *Central Bank* requires. Defendants who merely obtain or transmit legitimate documents knowing that they would later be falsified in order to misstate a company's financial condition would not be primarily liable under Rule 10b-5(a) and (c). Rather, such individuals would be, at most, aiders and abettors of a Rule 10b-5 violation, as they themselves did not commit a deceptive act. Similarly, defendants who engage in legitimate, rather than sham, transactions would not be primarily liable under Rule 10b-5(a) and (c), even if they "knew or intended that another party would manipulate the transaction to effectuate a fraud." *See, e.g., Simpson v. AOL Time Warner Inc.*, 452 F.3d 1040, 1047-50 (9th Cir. 2006), *vacated on other grounds sub nom. Avis Budget Group, Inc. v. Cal. State Teachers' Ret. Sys.*, 552 U.S. 1162 (2008). Again, such individuals could be liable only for aiding and abetting, as their own conduct was not itself deceptive.

74 131 S. Ct. at 2302-04.

75 817 F. Supp. 2d at 344.

concluded that, in any case involving misstatements, *Janus* precludes primary liability under Rule 10b-5(a) and (c) for all defendants who do not themselves "make" the misstatements, regardless of whether they engaged in deceptive conduct "beyond" the misstatements. That reading of *Janus* is without merit. It mistakenly assumes both that the Court intended to construe provisions that it never even mentioned and that the Court intended to give primacy to Rule 10b-5(b) at the expense of subsections (a) and (c). Indeed, as one court observed, "*Kelly* cast subsection (b) in Rule 10b–5's lead role and then crippled subsections (a) and (c) to ensure that they would never overshadow the star."[76]

C. Primary Liability Under Section 17(a)(1) and (a)(3)

1. Section 17(a) does not require conduct that is itself manipulative or deceptive.

As previously noted, Section 17(a) makes it unlawful, in the offer or sale of any security, "directly or indirectly . . . (1) to employ any device, scheme, or artifice to defraud"; (2) "to obtain money or property by means of any untrue statement of a material fact or any [material] omission"; or (3) "to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser."[77] Absent from these provisions is the language of Section 10(b) requiring that the proscribed conduct be "manipulative or deceptive."[78] There is therefore no textual basis for concluding that Rule 10b-5's requirement that the defendant's violative conduct itself be "manipulative or deceptive" also applies to Section 17(a).[79]

Our conclusion that Section 17(a) differs from Section 10(b) and Rule 10b-5 in this way is consistent with how the Supreme Court has approached these provisions. In *Ernst & Ernst v. Hochfelder*, the Court held that the "words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that Section 10(b) was intended to proscribe knowing or

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76 *Familant*, 910 F. Supp. 2d at 95. A number of district court have disagreed with *Kelly*'s reading of *Janus*. *E.g.*, *Sells*, 2012 WL 3242551, at *6-7; *Langford*, 2013 WL 1943484, at *8; *Garber*, 2013 WL 1732571, at *4; *SEC v. Geswein*, No. 5:10CV1235, 2011 WL 4541308, at *17 n.3 (N.D. Ohio Aug. 2, 2011), *adopted in relevant part*, 2011 WL 4565861 (N.D. Ohio Sept. 29, 2011).

77 15 U.S.C. § 77q(a).

78 *See id.* § 78j(b).

79 Nevertheless, some courts have, without meaningful analysis, described Section 17(a)'s proscriptions as "substantially identical" to those in Rule 10b-5. *E.g.*, *Landry v. All Am. Assurance Co.*, 688 F.2d 381, 386 (5th Cir. 1982); *SEC v. Monarch Funding Corp.*, 192 F.3d 295, 308 (2d Cir. 1999) ("Essentially the same elements are required under Section 17(a)(1)-(3) in connection with the offer or sale of a security" as under Rule 10b-5, "though no showing of scienter is required . . . under [Section 17](a)(2) or (a)(3)."); *SEC v. First Jersey Sec., Inc.*, 101 F.3d 1450, 1467 (2d Cir. 1996) ("With respect to § 17(a)(1), essentially the same elements [as in a Rule 10b–5 claim] must be established in connection with the offer or sale of a security.").

intentional"—rather than negligent—misconduct.[80] The Court acknowledged that portions of Rule 10b-5—subsections (b) and (c)—"could be read" to proscribe merely negligent behavior, but concluded that the language of the statute necessarily limited all three of the rule's subsections to scienter-based misconduct.[81] Just a few years later, in *Aaron v. SEC*, the Court determined that Section 17(a)(2) and (a)(3)—on which the language of Rule 10b-5(b) and (c) was patterned—do not require scienter.[82] Notably, the Court treated Section 17(a)(2) and (a)(3) differently from Rule 10b-5(b) and (c) because Section 17(a) lacked the language in Section 10(b) limiting it to "manipulative or deceptive device[s] or contrivance[s]."[83]

The Court's analysis in these cases—and its recognition of the textual differences between Section 17(a) and Section 10(b)—is consistent with our conclusion that Section 17(a) does not proscribe only conduct that is itself manipulative or deceptive.[84] Of course, as the Court explained in *Aaron*, Section 17(a)(1) requires a showing of scienter, or deceptive *intent*,[85] but we find that mental-state requirement distinct from the need to show, under Section 10(b), that the defendant's violative conduct is itself deceptive (or manipulative). And none of this is to suggest that liability may attach under Section 17(a) without any investors having been actually or potentially defrauded. Indeed, in any case brought under Section 17(a), there would need to be a showing that investors were or could have been defrauded. But that requirement too is distinct from the need to show that the defendant's *own conduct* was deceptive.[86]

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80 425 U.S. at 197.

81 *Id.* at 212-14.

82 446 U.S. at 695-97.

83 *See id.*

84 Leading commenters have also recognized that Section 17(a) may cover conduct that is not itself manipulative or deceptive because it does not contain the language of Section 10(b). *E.g.*, 4 Thomas Lee Hazen, *Treatise on the Law of Securities Regulation* § 12.22 ("Section 17(a) does not contain the phrase 'manipulative or deceptive device' that is found in Section 10(b) of the Exchange Act and has formed a basis of the scienter and deception requirements."); Donald C. Langevoort, *Fraud and Deception by Securities Professionals*, 61 Tex. L. Rev. 1247, 1293 (1983) ("Aside from [S]ection 10(b), [S]ection 17(a) of the Securities Act of 1933 is the broadest section prohibiting fraud 'in the offer or sale' of any security. It is not limited to deception or manipulation . . . .").

85 446 U.S. at 695-97.

86 *Accord Klamberg v. Roth*, 473 F. Supp. 544, 556 (S.D.N.Y. 1979) (noting that because Section 17(a) "is in many respects broader than [S]ection 10(b)," the Section 17(a) claims could survive even absent deceptive conduct by the defendant himself). We can conceive of a number of ways that a defendant might contribute to a fraud through conduct that is not itself deceptive or manipulative. For example, if a defendant company executed legitimate transactions with another entity knowing that the other entity would use the transactions to misstate its revenue, the defendant company could be liable under Section 17(a) even though the transactions were not themselves deceptive. *See, e.g.*, *Simpson*, 452 F.3d at 1050.

Policy considerations reinforce our reading of Section 17(a). As discussed, our approach is consistent with our longstanding policy of reading the securities laws broadly and flexibly—and rejecting technical or restrictive views that would unnecessarily limit our enforcement authority.[87] Further, our approach ensures that investors are appropriately protected from conduct in the offer or sale of securities that is not itself manipulative or deceptive—but nevertheless would operate as a fraud on those investors.

Finally, we note that nothing in *Janus* contradicts our understanding of Section 17(a). Indeed, we conclude—and nearly all courts to consider the issue agree—that *Janus* has no bearing on Section 17(a).[88] As previously noted, the term "make," which was central to the Court's analysis, is not in the operative language of any of Section 17(a)'s provisions. And in *Janus* the Court specifically explained that its reading of Rule 10b-5(b) was motivated, in part, by the need to "give narrow dimensions to" the scope of private actions under Rule 10b-5.[89] That concern is entirely inapplicable to claims brought under Section 17(a), for which there is no private right of action.[90]

2. Section 17(a)(1), like Rule 10b-5(a) and (c), encompasses misstatements and misstatement-related misconduct.

Like Rule 10b-5(a) and (c), we read the language of Section 17(a)(1) to encompass all scienter-based, misstatement-related misconduct. Indeed, Section 17(a)(1) is identical to Rule 10b-5(a) in prohibiting the "employ[ment]" of a "device," "scheme," or "artifice to defraud."[91] And, as explained above, a misstatement is undoubtedly a "device" or "artifice" to defraud.[92] Thus, one who (with scienter) "makes" a material misstatement in the offer or sale of a security has violated Section 17(a)(1)—such conduct surely constitutes "employ[ing]" a "device, scheme,

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87 *See, e.g., Kilpatrick*, 1986 WL 626187, at *5.

88 *E.g., Monterosso*, 756 F.3d at 1334 (stating that *Janus* addressed only "what it means to 'make' a statement for purposes of Rule 10b–5(b), and did not concern 17(a)(1) or (3)"); *Sentinel Mgmt. Group*, 2012 WL 1079961, at *14-15; *Stoker*, 865 F. Supp. 2d at 465-66 (collecting cases); 5 Alan R. Bromberg et al., *Bromberg & Lowenfels on Securities Fraud* § 7:306.58 (2d ed.) (collecting cases); *see also* Jacobs, *Disclosure and Remedies under the Securities Laws* § 12:113.99 (concurring that *Janus* does not affect the scope of liability under Section 17(a)). *But cf. Kelly*, 817 F. Supp. 2d at 345 (holding that *Janus*'s limitation on primary liability under Rule 10b-5(b) applies to Section 17(a)(2)).

89 131 S. Ct. at 2301-02, 2303 (internal quotation marks and alterations omitted).

90 Notably, we find irrelevant to our analysis of Section 17(a) (in particular, subsections (a)(1) and (a)(3)) the case law requiring conduct "beyond" a misstatement for claims arising under Rule 10b-5(a) and (c). Not only is that authority unpersuasive, as discussed, but the fact that the test arose from the requirement that Rule 10b-5 reach only manipulative or deceptive conduct renders it wholly inapplicable to Section 17(a) claims.

91 15 U.S.C. § 77q(a)(1).

92 *See Troice*, 134 S. Ct. at 1063.

or artifice to defraud." In our view, so too has any defendant who (with scienter) drafts or devises a misstatement or uses a misstatement made by others to defraud investors. In each case, the person has "employ[ed]" a "device" or "artifice to defraud."

We thus reject any suggestion that because Section 17(a)(2) expressly prohibits certain negligent misstatements, that limits the reach of Section 17(a)(1) by excluding from its purview all intentional, misstatement-related conduct.[93] To begin with, Section 17(a)(1) and (a)(2) address very different types of conduct—Section 17(a)(1) proscribes all scienter-based fraud, whereas Section 17(a)(2) prohibits negligent misrepresentations that deprive investors of money or property. And we have recognized that the subsections of Section 17(a) are "mutually supporting rather than mutually exclusive."[94] As the Supreme Court has expressly observed, "[e]ach succeeding prohibition [in Section 17(a)] is meant to cover additional kinds of illegalities—not to narrow the reach of the prior sections."[95]

We find that to read the provisions as mutually exclusive would inappropriately limit the Division's ability to charge fraudulent conduct and thereby protect investors. It would also effectively immunize under the Securities Act intentionally fraudulent misstatements (and misstatement-related conduct) that did not result in the defendant's obtaining money or property. We find such a result inconsistent with the text of the statute and the policy underlying it. Accordingly, we read Section 17(a)(1) to encompass the making, drafting, and devising of a misstatement, as well as other forms of conduct that contribute to a fraud.

3. Section 17(a)(3) encompasses misstatements only to the extent they can be deemed fraudulent transactions, practices or courses of business.

Section 17(a)(3) prohibits all "transaction[s]," "practice[s]," and "course[s] of business" that "operate[] or would operate as a fraud."[96] Although its language closely resembles Rule 10b-5(c), Section 17(a)(3) uses the term "transaction" rather than the broader term "act." We find that difference significant—while a misstatement (or misstatement-related activity) may fairly be characterized as an "act," a misstatement is not a "transaction."[97] Accordingly, we read Section 17(a)(3) to be narrower than Rule 10b-5(c) in this respect—*i.e.*, Section 17(a)(3) does

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93 *See, e.g.*, *Kelly*, 817 F. Supp. 2d at 345-46.

94 *Cady, Roberts & Co.*, 1961 WL 60638, at *4.

95 *United States v. Naftalin*, 441 U.S. 768, 774 (1979). Reading Section 17(a)(1) to encompass misstatements also does not cause Section 17(a)(2) to be wholly subsumed by Section 17(a)(1), because Section 17(a)(2) permits liability for negligence, whereas Section 17(a)(1) requires a showing of scienter. *See Aaron*, 446 U.S. at 695-97.

96 15 U.S.C. § 77q(a)(3).

97 *Compare* Webster's New International Dictionary 25 (def. 1) (2d ed. 1934) (defining "act" broadly as "[t]hat which is done or doing; the exercise of power, or the effect whose cause is power exerted; a performance; a deed") *with id.* 2688 (def. 2a) (defining "transaction" as "[a] business deal; an act involving buying and selling").

not encompass those "acts" proscribed by Rule 10b-5(c) that are not "transactions," "practices" or "courses of business."[98]

As a result, whereas Rule 10b-5(a) and (c) and Section 17(a)(1) all would proscribe even a single act of making or drafting a material misstatement to investors, Section 17(a)(3) is not susceptible to a similar reading. Of course, one who *repeatedly* makes or drafts such misstatements over a period of time may well have engaged in a fraudulent "practice" or "course of business," but not every isolated act will qualify.[99] And none of this is to suggest that the word "transaction" is not also an operative term in the statute—a transaction that itself operated or would operate as a fraud certainly could serve as the basis for primary liability, as well.

Despite being narrower than Rule 10b-5(c) in some respects, Section 17(a)(3) is broader than Rule 10b-5(c) (and Section 17(a)(1)) in others. As discussed above, Section 17(a)(3) does not require that the defendant have engaged in conduct that is itself deceptive (or manipulative). Nor does Section 17(a)(3) require a showing of scienter. Indeed, *Aaron* instructs that "the language of [Section] 17(a)(3)] . . . quite plainly focuses upon the effect of particular conduct on members of the investing public, rather than upon the culpability of the person responsible."[100] Section 17(a)(3)'s prohibition could apply, therefore, where, as a result of a defendant's negligent conduct, investors receive misleading information about the nature of an investment or an issuer's financial condition. It also might apply where, as a result of a defendant's negligence, prospective investors are prevented from learning material information about a securities offering.[101]

Once again, policy concerns support our conclusion. Our reading of Section 17(a)(3) affords the Division appropriate flexibility in charging—and protecting investors from—fraudulent transactions, practices, and courses of business in the offer or sale of securities. But it also stops short of granting the Division what some might view as unfettered authority to charge even an isolated, negligent misstatement that does not result in the receipt of money or property.

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98 *See* Jacobs, *Disclosure and Remedies under the Securities Laws* § 3:248 (suggesting that "the word 'transaction' in Section [17(a)(3)] is less broad than 'act' in [Rule 10b-5(c)]").

99 *See id.* at 1937 (def. 1b) (defining "practice," when used as a noun, in terms suggesting repeated conduct engaged in over time: "often, repeated or customary action; usage; habit; custom; . . . the usual mode or method of doing something"); *id.* 610 (def. 5) (defining "course," when used in phrases like "course of conduct," to mean "a succession of acts or practices" or "[a] series of motions or acts").

100 *Aaron*, 446 U.S. at 697 (emphasis omitted).

101 *See, e.g.*, *Johnny Clifton*, Securities Act Release No. 9417, 2013 WL 3487076, at *10 (July 12, 2013) (finding a Section 17(a)(3) violation because defendant "conceal[ed] material adverse information" from "sales representatives" and "ensure[d] that sales representatives who learned such information also withheld it from prospective investors").

IV.

Under the standards set forth above, we find Hopkins liable under Rule 10b-5(a), (b), and (c), as well as Section 17(a)(1). We find Flannery liable under Section 17(a)(3).[102]

A. Hopkins

The Division alleges that Hopkins violated Section 10(b), Rule 10b-5(b), and Section 17(a)(2) by making misrepresentations in three different communications: the Typical Portfolio Slide, the ABX Holdings Slide, and oral statements to Hammerstein during the April 9, 2007 conference call. The Division also alleges that Hopkins violated Section 17(a)(2)—but not Section 10(b) or Rule 10b-5(b)—through his use of misrepresentations in two separate communications: the Fact Sheets and the March 2007 letter. Finally, the Division claims that through all of these communications—as well as his involvement with the July 26, 2007 letter—Hopkins "engaged in a scheme to defraud, and a course of business [that] operated as a fraud" in violation of Rule 10b-5(a) and (c) and Section 17(a)(1) and (a)(3).

We address each alleged instance of misconduct in turn, considering whether it meets the criteria set forth above for liability under the subsections of Rule 10b-5 and Section 17(a). We conclude that Hopkins violated Rule 10b-5(a), (b), and (c), as well as Section 17(a)(1), with respect to the Typical Portfolio Slide, but we find him not liable for his conduct relating to the other communications.

1. The Typical Portfolio Slide

a. The Typical Portfolio Slide Was Misleading.

As previously explained, the PowerPoint presentation provided to existing and prospective LDBF investors included a slide describing LDBF's "typical" portfolio by sector. The slide consistently represented that only 55% of the fund was invested in ABS, when, in reality, LDBF was substantially more invested in ABS. Indeed, notwithstanding the information on the slide, LDBF's *actual* ABS exposure was: (i) 68.5% on September 30, 2006; (ii) 85.7% on December 31, 2006; (iii) 100% on March 31, 2007; and (iv) 81.3% on June 30, 2007. Given the magnitude of the difference between the represented "typical" versus actual exposure levels across this time period, we find the slide misleading.

Hopkins contends that the slide was not misleading because it showed LDBF's "typical," rather than "actual," sector breakdown—and, he claims, the 55% investment level *was* fairly typical, at least through 2004. That argument is unconvincing, as the slide did not even come close to truthfully representing LDBF's "typical" portfolio during the relevant time period—late 2006 through mid-2007. Moreover, the only testimony on this point demonstrates that at least

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102 We apply a preponderance of the evidence standard in determining whether the record supports the Division's claims. *See Steadman v. SEC*, 450 U.S. 91, 102 (1981). We note that the law judge found the Respondents to be credible witnesses; none of our conclusions are inconsistent with that finding.

one consultant was in fact misled as to LDBF's exposure level: Hammerstein testified that he believed that LDBF was about 55% invested in ABS after he was shown the Typical Portfolio Slide in his May 10, 2007 meeting with Hopkins. At that time, LDBF's actual exposure to ABS was around 100%.

b. The Misrepresentations in the Typical Portfolio Slide Were Material.

For a misleading statement to be material, "there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[103] We have held that omissions about changes to portfolio composition meet this standard because "reasonable investors would have considered it important" to know that a fund had changed its portfolio composition and thereby increased its risk profile.[104] Here, we similarly conclude that reasonable investors would have viewed disclosure of the fact that, during the relevant period, LDBF's exposure to ABS was substantially higher than was stated in the slide as having significantly altered the total mix of information available to them.

Hopkins makes three primary arguments against such a finding. *First*, he contends that, even if the omitted facts *were* material, they became so only *after* the financial crisis hit in July 2007. In support, he notes that, in early 2007, investors who were given more accurate information about LDBF's risk profile did not immediately redeem their shares. But, as discussed above, we consider misleading statements about the nature of investments to be material to investors *regardless* of when they are made.[105] Moreover, a misrepresentation can be material as long as a reasonable shareholder would deem it "important" to his deliberations; the standard does not require proof "that disclosure of the omitted fact would have caused the reasonable investor to change" his behavior.[106] Thus, the fact that some investors learned the

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103 *Basic Inc. v. Levinson*, 485 U.S. 224, 231-32 (1988).

104 *Fundamental Portfolio Advisors, Inc.,* Exchange Act Release No. 48177, 56 SEC 651, 2003 WL 21658248, at *11-12 (July 15, 2003) (fund's changes to its portfolio resulting in increased interest rate risk and longer duration were material), *pet. denied sub nom., Brofman v. SEC*, 167 F. App'x 836, 838 (2d Cir. 2006) (finding that "[s]ubstantial evidence supports the SEC's finding of materiality"); *see also, e.g., Freudenberg v. E*Trade Fin. Corp.*, 712 F. Supp. 2d 171, 182-84 (S.D.N.Y. 2010) (allegations that defendant misrepresented its loan portfolio as containing "superprime" or safer-than-prime loans, when the loans were subprime or of lower quality, satisfied materiality pleading requirements); *In re MoneyGram Int'l, Inc. Sec. Litig.*, 626 F. Supp. 2d 947, 975-78 (D. Minn. 2009) (finding that the "concealment of specific information related to the Portfolio's subprime exposure and contents" may have misled a reasonable investor).

105 *Cf. Freudenberg.*, 712 F. Supp. 2d at 177, 182 (recognizing that misleading disclosures about subprime exposure were material even before July 2007); *In re MoneyGram Int'l, Inc. Sec. Litig.*, 626 F. Supp. 2d at 975-78 (same).

106 *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

truth about LDBF's risk profile and did not immediately redeem their shares does not establish that the omitted information was necessarily immaterial.

Second, Hopkins states that the following "factor[s]" support a determination that the omitted information was not material: "(1) the slide 'on its face states that it is typical,' (2) State Street provided information upon request about its actual LDBF portfolio, (3) such information was available from a variety of sources, (4) enhanced cash strategies were widely discussed in the press and well known in the financial community, (5) Hopkins brought current information about the portfolio's allocation to his presentations, and (6) most investors did not inquire into the composition of a fund's portfolio." We take his argument to be that the information was not material because it was available to LDBF investors had they sought it out (as some, but not all, did), and the financial community was sufficiently apprised of investment strategies like LDBF's that investors would have inquired about LDBF's actual portfolio composition if it was important to them.

We are not persuaded. None of the facts Hopkins cites establishes that a reasonable investor who received the Typical Portfolio Slide would not consider information about LDBF's actual portfolio composition as having altered the total mix of information available to them. Indeed, in *SEC v. Morgan Keegan & Co., Inc.*, the Eleventh Circuit rejected the argument that accurate disclosures that would have been "available to any 'reasonably diligent investor'" rendered certain oral misrepresentations about an investment immaterial.[107] There, like here, the misrepresentations were made directly to prospective investors, and corrective information was available only upon request or through the investors' own research efforts. Other courts have reached analogous conclusions, similarly rejecting claims that once financial information enters the public domain (albeit in a very limited fashion), that alone relieves the speaker of any duty to disclose information necessary to make his statements not misleading.[108] It would send an extraordinarily dangerous message to say that Hopkins was free to make any misstatements about LDBF he wished in his presentations, so long as he could later claim that investors could have obtained accurate information about the fund if they had only known to ask.

Third, Hopkins claims that because most LDBF investors were relatively sophisticated, any details about the fund's holdings and risk profile that were omitted from the Typical Portfolio Slide were not material to them. The Supreme Court, however, has long instructed that "[t]he question of materiality . . . is an objective one, involving the significance of an omitted or

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[107] 678 F.3d at 1252-53.

[108] *E.g.*, *New Jersey Carpenters Health Fund v. Royal Bank of Scotland*, 709 F.3d 109, 127 (2d Cir. 2013) (explaining that "'[t]here are serious limitations on a corporation's ability to charge its stockholders with knowledge of information omitted from a document such as a . . . prospectus on the basis that the information is public knowledge and otherwise available to them'"); *Dolphin & Bradbury, Inc. v. SEC*, 512 F.3d 634, 641 (D.C. Cir. 2008) (rejecting argument that defendant did not have a duty to disclose information that was necessary to make statements not misleading given that information "was technically in the public domain," as the information "was not reasonably available to investors").

misrepresented fact to a reasonable investor."[109] It has reiterated that position on multiple occasions, finding "no authority in the statute, the legislative history, or [its] previous decisions, for varying the standard of materiality depending on" the recipient of "the withheld or misrepresented information."[110]

Indeed, the Court recently confirmed that view in *Amgen Inc. v. Connecticut Retirement Plans and Trust Funds*, a case holding that proof of materiality is not a prerequisite for certifying a securities-fraud class action.[111] Crucial to its holding was the Court's conclusion that "because materiality is judged according to an objective standard," the "alleged misrepresentations and omissions, whether material or immaterial, would be so equally for all investors composing the class."[112] The Court emphasized that "[i]n no event will the individual circumstances of particular class members bear on the [materiality] inquiry."[113]

Further, the courts of appeals do not consider investor sophistication when evaluating the materiality of misrepresentations and omissions.[114] *SEC v. Happ*[115] and *Alton Box Board Co. v. Goldman, Sachs & Co.*,[116] which Respondents cite, are not to the contrary.[117] In *Happ*, the court

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109 *TSC Indus.*, 426 U.S. at 445; *see Basic*, 485 U.S. at 232 (explicitly adopting the *TSC Industries* materiality standard for Section 10(b) actions).

110 *Basic*, 485 U.S. at 240 & n.18; *see also Matrixx Initiatives, Inc. v. Siracusano*, 131 S. Ct. 1309, 1318, 1321-22 (2011) (emphasizing that materiality is weighed from the perspective of the "reasonable investor"); *Virginia Bankshares, Inc. v. Sandberg*, 501 U.S. 1083, 1097-98 (1991) (same; rejecting the proposition that materiality should be evaluated from the perspective of a "financial analyst").

111 133 S. Ct. 1184, 1195 (2013).

112 *Id.* at 1191.

113 *Id.*

114 *See, e.g.*, *Folger Adam Co. v. PMI Indus., Inc.*, 938 F.2d 1529, 1535 (2d Cir. 1991) (holding that, although the court was "sympathetic to appellees' claim that Folger Adam is a sophisticated investor," "reasonable minds could differ as to whether a *reasonable investor* in Folger Adam's position would have considered appellees' omissions and alleged misstatements" to be material (emphasis added)).

115 392 F.3d 12 (1st Cir. 2004).

116 560 F.2d 916 (8th Cir. 1977).

117 Other cases Respondents cite are inapposite because they consider investor sophistication not for purposes of materiality, but only in the context of reliance or scienter. *E.g.*, *Banca Cremi, S.A. v. Alex. Brown & Sons, Inc.*, 132 F.3d 1017, 1032 (4th Cir. 1997) (considering investor sophistication in context of reliance argument); *Myzel v. Fields*, 386 F.2d 718, 735-37 (8th Cir. 1967) (same); *Martin v. Steubner*, 485 F. Supp. 88, 97 (S.D. Ohio 1979) (considering defendant's perception of investor's sophistication when evaluating defendant's scienter), *aff'd*, 652 F.2d 652 (6th Cir. 1981); *Berger v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 505 F. Supp. 192, 194 (S.D.N.Y. 1981) (same). Similarly, *Scarfarotti v. Bache & Co., Inc.*, 438 F.

(continued...)

observed that the defendant's financial sophistication might have caused him to recognize the importance of the inside information he received, but it still applied the "reasonable investor" standard when concluding that the information in question was material.[118] In *Alton Box*, the court noted that the facts of the case involved sophisticated institutional purchasers but held that the relevant question for the trier of fact was the materiality of the information to a "reasonable shareholder."[119] And to the extent the district court cases Respondents cite consider investor sophistication when analyzing materiality, we find such approach in tension with the Supreme Court's guidance in *TSC Industries*, *Basic*, and *Amgen.*[120]

Finally, we note that even if LDBF investors were relatively sophisticated about investing, generally, the evidence does not establish that they (or the consultants many of them employed to assist with investment decisions) were uniformly sophisticated about fixed income investing, in particular. Thus, even under the subjective materiality inquiry Hopkins proposes, we still would find that disclosure of the information omitted from the Typical Portfolio Slide

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Supp. 199, 205-06 (S.D.N.Y. 1977), discussed investor sophistication but found the plaintiffs' claims unavailing *not* because the statements made were immaterial, but because they were not misleading and were not the cause of the plaintiffs' alleged losses. Finally, *Seibert v. Sperry Rand Corp.*, 586 F.2d 949, 951-52 (2d Cir. 1978), held that omitted facts were immaterial because they were "trivial" and "already in the public domain," not because the investors were sophisticated.

118 *Happ*, 392 F.3d at 21-22 (stating that because the defendant "was a financial expert and had closely followed the affairs of" the company, the jury could "find him capable of drawing reasonable inferences" from information received from" the company's CEO); *id.* at 23 n.4 ("[I]n the circumstances here . . . there is a substantial likelihood that a reasonable investor would consider the" tipped information "significant."). Moreover, *Happ* is especially inapposite here because it did not *impute* financial sophistication to a large set of investors—as Respondents argue we should do here—but rather looked to the facts that a single defendant *actually knew* when evaluating his response to receiving inside information. *See* 392 F.3d at 22-23.

119 *Alton Box*, 560 F.2d at 922.

120 Nonetheless, those cases are distinguishable. In *SEC v. Rorech*, 720 F. Supp. 2d 367, 372 (S.D.N.Y. 2010), the court found alleged inside information not material because it was publicly available, not because the investors were sophisticated. And while *Drobbin v. Nicolet Instrument Corp.*, 631 F. Supp. 860, 891 (S.D.N.Y. 1986), and *Quintel Corp. v. Citibank, NA,* 596 F. Supp. 797, 802 (S.D.N.Y. 1984), consider investor sophistication when evaluating "the adequacy of disclosure" to investors (as well as reliance), at least two appellate courts have held that materiality and "the adequacy of disclosure" are analytically distinct concepts. *See Isquith v. Middle S. Utilities, Inc.*, 847 F.2d 186, 207-08 (5th Cir. 1988) (distinguishing "adequacy of disclosure" from materiality and holding that both are objective inquiries); *Durning v. First Boston Corp.*, 815 F.2d 1265, 1268 (9th Cir. 1987) (same).

(LDBF's *actual* investment level in ABS) would have "significantly altered the 'total mix' of information made available" to LDBF's investors.[121]

c. Hopkins Acted with Scienter with Respect to the Misrepresentations in the Typical Portfolio Slide.

Under Rule 10b-5 and Section 17(a)(1), Hopkins may be held liable if he acted with extreme recklessness; he need not have had actual knowledge that his misrepresentations would mislead investors.[122] That said, the preponderance of the evidence establishes that Hopkins did know that the Typical Portfolio Slide was misleading when it was provided to investors and consultants. Hopkins admitted that he knew the allocations listed on the slide were not "typical" (as the slide claimed), and his own notes on his copies of the slide demonstrate his knowledge of LDBF's actual portfolio composition when he gave the presentations. For example: for the July 2006 presentation to Johns Hopkins, Hopkins noted that 90% of LDBF's assets were in ABS; for the December 2006 presentation to Kalson, Hopkins noted that 80% of LDBF was invested in ABS; and for the February 2007 presentation to LACERA, Hopkins noted that 90% of LDBF was in ABS. At the very least, we find this evidence shows that Hopkins must have known that the Typical Portfolio Slide would mislead LDBF investors, and he recklessly disregarded that fact.[123]

Hopkins argues, in effect, that even if he knew the slide was misleading, the Division still failed to demonstrate that he knew or recklessly disregarded the *materiality* of the slide's misrepresentations because "nobody at the time thought the omitted information was important." As discussed above, however, we find that the omitted information was in fact material to investors at the time of the presentations, notwithstanding that the industry did not yet fully appreciate the danger of subprime investments. Moreover, we find that the Division adequately established that Hopkins knew (or at least recklessly disregarded) that the Typical Portfolio Slide's misleading omissions were material *to LDBF investors*. Hopkins found information about the fund's actual portfolio composition sufficiently important that he made note of it on his copies of the presentation slides. And the record shows that, on numerous occasions in 2006 and 2007, he responded to requests from investors, consultants, and client-facing SSgA personnel about LDBF's actual subprime RMBS exposure. The very fact of these inquiries—and his responses—shows that Hopkins must have appreciated that the information was important to LDBF investors.[124]

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121 *See Basic*, 485 U.S. at 232.

122 *See Rockies Fund*, 428 F.3d at 1093; *Ficken*, 546 F.3d at 47-48.

123 As previously noted, there is no evidence that Hopkins corrected the misleading information in the Typical Portfolio Slide during the presentations in which he participated.

124 *See Dolphin & Bradbury,* 512 F.3d at 643 (finding that investor inquiries demonstrated that the defendant "must have known the information was important to investors" (internal quotation marks omitted)).

In sum, we find that Hopkins acted with the requisite scienter because he knew that omitting the information at issue from the Typical Portfolio Slide posed a danger of misleading investors and, in any event, that danger was so obvious that he must have been aware of it.[125]

d. Hopkins "Made" the Statement in the Typical Portfolio Slide.

We find that, at least with respect to the May 10, 2007 presentation to National Jewish, Hopkins "made" the misrepresentations in the Typical Portfolio Slide and therefore is liable under Rule 10b-5(b). Hammerstein testified specifically that Hopkins presented the slide during the meeting, that he did so without divulging LDBF's actual portfolio composition, and that Hammerstein understood from the slide that LDBF was very diversified by sector.[126] The evidence also shows that: (i) Hopkins was responsible for ensuring the accuracy of the information in the Typical Portfolio Slide; (ii) Hopkins's name appeared on the cover of PowerPoint presentations containing the slide that were provided to investors and consultants for meetings in which Hopkins was one of the lead presenters; and (iii) Hopkins made handwritten notes on the Typical Portfolio Slide in preparation for the presentations, suggesting that he was responsible for the portion of the presentation that covered the information in the slide. From this evidence, we conclude that Hopkins had "ultimate authority over the statement, including its content and whether and how to communicate it"[127]—at least with respect to the May 10, 2007 presentation.[128]

The only evidence that Hopkins did *not* present the Typical Portfolio Slide is his own testimony that he "never addressed the[] sector breakdowns [in the Typical Portfolio Slide] and . . . was never asked a question on them." But Hopkins *also* testified that he did not recall whether he discussed or was ever "asked a question about" the Typical Portfolio Slide. If he

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125 *Cf. id.* (rejecting argument that defendant lacked scienter because he, personally, did not believe omitted facts would be material to investors and because, he claimed, "the danger of non-disclosure was not obvious" at the time of the investment decision); *Fundamental Portfolio Advisors*, 2003 WL 21658248, at *13 (rejecting argument that nondisclosure of changes to portfolio cannot be reckless if defendant's approach was consistent with industry practice at the time).

126 The law judge found Hammerstein to be a credible witness, and we found no compelling evidence in the record contradicting Hammerstein's account of the May 10 meeting. *See Flannery*, 2011 WL 5130058, at *40 n.78.

127 *Janus*, 131 S. Ct. at 2302 ("One 'makes' a statement by stating it.").

128 Although Hopkins may have personally presented the Typical Portfolio Slide during other investor presentations, the record does not establish that he did. We therefore cannot conclude that he "made" misrepresentations in connection with those presentations. Moreover, because we find that he "made" only the one misrepresentation, we need not address Hopkins's argument that it would be inappropriate to attribute to him statements made in *other* presentations where the only evidence in support of such a finding is that his name appears on the cover of the slide presentation.

does not recall any discussion at all about the slide, then his certainty that he never addressed or was questioned about the "sector breakdowns" is questionable—and certainly not compelling.[129]

e. Hopkins's Misrepresentation in the Typical Portfolio Slide Constitutes a Deceptive "Device" and "Artifice to Defraud," as well as a Deceptive "Act."

For the reasons discussed above, we believe that the "maker" of a misstatement necessarily has employed a "device" or "artifice to defraud" for purposes of liability under Rule 10b-5(a) and Section 17(a)(1), and that such conduct is "deceptive" as required by Rule 10b-5(a). "Making" a misstatement also constitutes engaging in a deceptive "act" for purposes of liability under Rule 10b-5(c). Therefore, having found that Hopkins "made" the misstatement in the Typical Portfolio Slide, at least with respect to the National Jewish presentation, we conclude that he also employed a device or artifice to defraud, in violation of Section 17(a)(1) and Rule 10b-5(a), that he engaged in an "act" which operated or "would operate as a fraud or deceit," in violation of Rule 10b-5(c), and that his conduct was deceptive, in violation of Section 10(b).

As for the other presentations before which attendees received copies of the Typical Portfolio Slide, we find that the record does not support holding Hopkins liable under Rule 10b-5(a) or (c) or Section 17(a)(1) for having employed a "device" or "artifice to defraud" or having engaged in a deceptive "act." As discussed above, Hopkins *could* be liable under those provisions for his decision not to revise the Typical Portfolio Slide before it was distributed to meeting attendees, regardless of whether he, personally, presented the information and therefore "made" the misleading statements to investors. His conduct—approval of the misleading language—certainly *could* constitute a deceptive "device" or "artifice to defraud," as well as a deceptive "act." But, on this record, it is unclear precisely how the information in the slide was presented and whether Hopkins or anyone else corrected the misrepresentations in the slide during the meetings. Accordingly, we cannot hold Hopkins liable under Rule 10b-5(a) or (c) or Section 17(a)(1) with respect to those presentations.

f. Hopkins Did Not "Obtain Money or Property by Means of" the Misrepresentation in the Typical Portfolio Slide.

Hopkins argues that the Division failed to establish, as Section 17(a)(2) requires, that he "obtain[ed] money or property by means of" the misstatements in the Typical Portfolio Slide. We agree that the Division failed to show that any money or property was obtained "by means of" the misrepresentations in the Typical Portfolio Slide.[130] We are persuaded by courts that

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129 We also find not compelling Hopkins's claim that *if* he presented the Typical Portfolio Slide to investors, then "it is as likely as not that he also supplied the actual, current sector allocations to his audience." He points to no evidence in support of such claim.

130 We note that the few district courts that have addressed the scope of Section 17(a)(2)'s requirement that a defendant "obtain money or property" are split on whether the defendant must have personally "obtain[ed]" money or property, or whether a benefit to his employer suffices. *Compare SEC v. Syron*, 934 F. Supp. 2d 609, 639-40 (S.D.N.Y. 2013) (requiring a showing that the defendant "personally gained money or property from" the alleged fraud); *Daifotis*, 2011 WL

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have held that liability under Section 17(a)(2) requires that a defendant obtain money or property "by use of" misleading information, suggesting the need for a causal link between the misrepresentation and the acquisition of money or property.[131] Accordingly, we conclude that a misrepresentation must be at least relevant to, if not the cause of, the transfer of money or property from an investor to the defendant (or perhaps his employer).[132]

The Division claims that merely because Hopkins "made" the misstatement in the Typical Portfolio Slide, he "therefore 'used'" that misstatement to obtain money or property. But the Division failed to show any connection between Hopkins's use of the misleading information and either Hopkins's or SSgA's acquisition of money or property. Accordingly, we find that Hopkins cannot be held liable under Section 17(a)(2) with respect to the Typical Portfolio Slide.[133]

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2183314, at *10 (same); *SEC v. Burns*, No. 84-0454, 1986 WL 36318, at *3-4 (S.D. Cal. Feb 19, 1986) (same) *with Stoker*, 865 F. Supp. 2d at 463 (holding that under Section 17(a)(2), it would be sufficient to show *either* that a defendant "personally obtained money indirectly from the fraud" *or* that he "obtained money or property for his employer while acting as its agent"); *SEC v. Mudd*, 885 F. Supp. 2d 654, 669-70 (S.D.N.Y. 2012) (adopting *Stoker* test); *SEC v. Delphi Corp.*, No. 06-14891, 2008 WL 4539519, at *20 (E.D. Mich. Oct. 8, 2008) (holding that "Section 17(a)(2) does not require that" a defendant "obtain money or property for themself"). But we need not resolve that question today, given our finding that the Division did not show that any money or property was obtained "by means of" the misrepresentations.

131 *Stoker*, 865 F. Supp. 2d at 465; *cf. Tambone*, 550 F.3d at 127-28 (requiring that the misrepresentation be "*used* 'to obtain money or property'"). We note that *Stoker*, which embraced the more expansive test for whether one has "obtain[ed]" money or property, still required a showing that the money or property be obtained "by use of" the misstatement. 865 F. Supp. 2d at 465.

132 *Cf. Loughrin v. United States*, 134 S. Ct. 2384, 2393-94 (2014) (explaining that the phrase "by means of" in the federal bank fraud statute, 18 U.S.C. § 1344(2), which makes it a crime to "knowingly execut[e] a scheme . . . to obtain" property owned by, or under the custody of, a bank "by means of false or fraudulent pretenses," imposes a "significant *textual* limitation on § 1344(2)'s reach": "It demands that the defendant's false statement is the mechanism naturally inducing a bank (or custodian) to part with its money").

133 The Division arguably asserts that SSgA and Hopkins "obtained money or property" by inducing investors who otherwise might have redeemed their shares in LDBF to remain in the fund. But the Division does not explain how such a claim would satisfy the requirement that Hopkins "*obtain*[ed]" money or property by means of his misrepresentations and did not pursue this theory at oral argument. Rather, at oral argument, counsel for the Division suggested that Hopkins's receipt of salary and/or bonus payments during the course of his employment could satisfy the "obtained money or property" requirement, on the theory that Hopkins successfully "obtained" money for his employer, some of which was passed on to him. However, under the assumption that an employer's receipt of money or property would suffice for liability, the Division has nevertheless failed to explain how, if at all, State Street's receipt of money or property was tied to, or dependent upon, Hopkins's alleged misconduct.

g. Hopkins's Conduct with Respect to the Typical Portfolio Slide Does Not Constitute a "Practice" or "Course of Business" that Operated as a Fraud on LDBF Investors.

As previously explained, while not every isolated act of making, drafting, or employing a misstatement will qualify as a "practice" or "course of business" with a deceptive "effect . . . on member[s] of the investing public,"[134] an individual's repeated use of a misleading statement may satisfy that standard. If the record were clear that Hopkins personally presented the information in the Typical Portfolio Slide to investors on more than one occasion, or that others presented the information he had approved—and that, in either case, the information was presented without disclosure of LDBF's actual portfolio composition—this might be such a case. But the evidence establishes only that Hopkins made one such presentation, and the record is unclear as to how the information was presented at the other meetings. Accordingly, we find that Hopkins's conduct does not rise to the level of a "practice" or "course of business" that operated (or would have operated) as a fraud on LDBF's investors. He therefore is not liable under Section 17(a)(3) for his conduct relating to the Typical Portfolio Slide.

2. The Fact Sheets

The Division alleges that Hopkins provided misleading information to investors through LDBF's quarterly Fact Sheets. Specifically, the Division claims that the Fact Sheets were misleading because: (i) they "falsely represented that LDBF was sector diversified" when "Hopkins knew the fund was virtually all subprime RMBS"; (ii) they described LDBF's exposure to ABS but fraudulently omitted that all of the ABS exposure was actually subprime RMBS; and (iii) they "misleadingly concealed the risk of LDBF by omitting LDBF's significant use of leveraged subprime investments."[135] The record does not support the Division's claims.

First, the Division takes issue with the statement in the narrative section of LDBF's Fact Sheets that the fund's "[s]trategy has better sector diversification" than "a typical 2 A-7 regulated money market portfolio."[136] To determine whether that was false or misleading, it would be necessary to know how LDBF's strategy differed from that of "a typical 2 A-7 regulated money market" fund. But the Division made no such showing.

Second, the Division takes issue with the chart in the Fact Sheets' data section that displayed LDBF's "sector weights," showing the percentage of the fund's investments allocated to different market sectors, including ABS. The Fact Sheets did not define the market sector categories or elaborate on LDBF's holdings within each category. Nor did they include a specific category for subprime RMBS; rather, all RMBS investments were included within the

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134 *Aaron*, 446 U.S. at 697 (emphasis omitted).

135 In the OIP, the Division made additional allegations as to why the Fact Sheets were misleading. *See* OIP, 2010 WL 3826277, at *4-5. It does not press those arguments on appeal, so we do not address them here.

136 A "2A A-7 regulated money market portfolio" is a fund regulated under Investment Company Act Rule 2a-7. *See* 17 C.F.R. § 270.2a-7.

ABS category. The Division claims that by classifying all of the RMBS investments as ABS, the Fact Sheets misled investors. But the Division does not dispute that such classification was technically correct—it just insists that it was nevertheless misleading to omit the *additional* fact that the investments were RMBS. We disagree; the Fact Sheets did not become misleading simply because a chart illustrating LDBF's ABS exposure failed also to show ABS subcategories (such as RMBS, securities backed by credit cards, auto loans, airplane leases, etc.).[137]

Finally, the Division contends that the Fact Sheets should have acknowledged "LDBF's significant use of leveraged subprime instruments" and that the chart described above improperly failed to show the fund's "actual" investment risk. Had the Fact Sheets described the "sector weights" of the fund's holdings by "notional value," instead of "market value," the Division contends, it would have revealed LDBF's extensive use of leverage, which significantly increased its exposure to ABS.[138] But, again, information that was provided accurately did not become misleading simply because it could have been presented differently.[139] Thus, we conclude that Hopkins cannot be held liable with respect to the Fact Sheets.

3. The March 2007 Letter

The Division asserts that Hopkins is liable for statements in the March 2007 letter, which, according to the Division, misleadingly downplayed LDBF's exposure to RMBS. But we find it significant that the purpose of the letter was not to address LDBF in particular but rather to discuss all of SSgA's "active funds." And the letter was clear that it was not intended "to present an in-depth treatise of" LDBF's performance, but rather "to broadly outline the reasons for and magnitude of" recent events and "to outline the impact of [those events] on the market generally and . . . [SSgA's] Funds more specifically." Moreover, it is not surprising that the letter omitted

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137 *Cf. Matrixx Initiatives*, 131 S. Ct. at 1321 (Rule 10b-5(b) "do[es] not create an affirmative duty to disclose any and all material information"; "[d]isclosure is required . . . only when necessary 'to make . . . statements made, in the light of the circumstances under which they were made, not misleading'"); *Basic*, 485 U.S. at 237 n.17 ("Silence, absent a duty to disclose, is not misleading under Rule 10b-5."). Notably, the Division does not allege (and the record does not suggest) that the Facts Sheets misrepresented the percentage of LDBF's ABS exposure.

138 *See* OIP, 2010 WL 3826277, at *5-6. "Notional value" refers to the total value of a leveraged position's exposure. Through the use of leverage, market participants are able to acquire exposure to a large dollar amount of an asset (the notional value) with only a small down payment. *See, e.g.*, *Use of Derivatives by Investment Companies Under the Investment Company Act of 1940*, Investment Company Act Release No. 29776, 2011 WL 3855065, at *28 n.32 (Aug. 31, 2011) (concept release).

139 Although we do not find liability based on this allegation, we reiterate our general belief that omission of material information about the use of leverage and its associated risks can provide a basis for liability. *Cf. Philip L. Spartis*, Exchange Act Release No. 64489, 2011 WL 1825026, at *9 (May 13, 2011) (finding customer communications to be materially misleading by presenting an unduly optimistic picture of the potential gains that would result under an investment strategy and by omitting downside risk analysis including the potential adverse consequences of financing the transactions on margin).

information about LDBF's exposure to RMBS, as it is undisputed that the cause of LDBF's underperformance at the time was its exposure to BBB-rated investments—*not* its total exposure to subprime RMBS. Accordingly, we find Hopkins not liable in connection with the March 2007 letter.

4. The April 9, 2007 Conference Call

The Division contends that Hopkins made oral misrepresentations to Hammerstein and others from Yanni Partners during the April 9, 2007 conference call. Specifically, the Division alleges that Hopkins misleadingly stated that LDBF's total exposure to subprime RMBS was only 2%, when in fact it was far higher (80% or more). The record does suggest that call participants may have been confused about whether Hopkins's comments about LDBF's 2% exposure to *BBB-rated investments* encompassed LDBF's exposure to *all* subprime RMBS. But the evidence does not indicate that Hopkins made the categorically broad—and misleading—statements the Division alleges. We therefore find Hopkins not liable with respect to the April 9 conference call.

5. The ABX Holdings Slide

The Division alleges that the ABX Holdings Slide used in presentations to Catholic Healthcare and National Jewish on April 25 and May 10, 2007, respectively, contained materially misleading information. By failing to correct the slide, the Division claims, Hopkins violated Rule 10b-5 and Section 17(a). We disagree. The slide itself may have been misleading in that it reported a *reduction* in exposure to BBB-rated investments without acknowledging that a subsequent *increase* in investment level effectively offset that reduction. But the record indicates that Hopkins nonetheless provided correct information about LDBF's BBB-rated holdings, at least during his presentation to National Jewish, thus indicating the subsequent increase. And because the record does not indicate what Hopkins said during the presentation to Catholic Healthcare,[140] we cannot conclude that he did not also correct the information in the ABX Holdings Slide during that presentation. Accordingly, we find Hopkins not liable for misleading investors by using the ABX Holdings Slide.

6. The July 26, 2007 Letter

Finally, the Division alleges that Hopkins is liable for misrepresentations in the July 26 letter. It asserts that the letter was misleading because: (i) it implied that LDBF's risk profile had been reduced when it had actually increased; and (ii) it omitted important details about LDBF, including its subprime concentration, use of leverage, inconsistent credit quality, and SSgA's views about whether investors should remain invested in the fund. Both of those theories fail for the same reason. Like the March 2007 letter, the July 26 letter was not specifically addressed to LDBF or any other single fund; rather, its purpose was to discuss generally

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140 Hopkins's handwritten notes on his copy of the Catholic Healthcare presentation included up-to-date statistics for LDBF's BBB-rated holdings, but Hopkins did not recall whether he conveyed the updated information to Catholic Healthcare. The record does not reflect anyone else's recollection of the meeting.

"problems in the subprime mortgage market" that had affected SSgA's "active fixed income portfolios." Thus, we find that the statement about efforts "to reduce risk in those portfolios where . . . appropriate" reflects a general observation about SSgA's overall strategy for all of its funds, not a statement about actions taken with regard to LDBF, in particular. Moreover, because the letter was not specifically focused on LDBF, nothing in the letter became misleading solely because it omitted certain details about the fund. Accordingly, we find that Hopkins may not be held liable with regard to the July 26 letter.

B. Flannery

In addition to alleging liability for the July 26 letter, which we have already found not misleading, the Division alleges that Flannery contributed to and/or approved misleading statements in the August 2 and August 14 client letters. More generally, the Division argues that Flannery "played a management role in SSgA's scheme to sell" LDBF's higher-quality assets to satisfy redemptions and "mislead investors who had not yet decided to redeem." For that asserted misconduct, the Division contends that Flannery is liable under Rule 10b-5(a) and (c) and Section 17(a)(1), (a)(2), and (a)(3).[141] We conclude that Flannery violated Section 17(a)(3) but not the other provisions.

1. Flannery's Alleged "Scheme" to Defraud LDBF Investors

Before turning to the particular misrepresentations alleged, we briefly explain the Division's overall theory of Flannery's liability. According to the Division, Flannery orchestrated a fraudulent course of business that misled investors by understating the risk of LDBF after July 25, 2007. Flannery knew, the Division claims, that as the subprime market was collapsing in July 2007, other officials at SSgA had begun to view LDBF as a poor investment. SSgA's own funds intended to redeem their interests in LDBF, and SSgA's internal advisory groups were recommending to their clients that they also withdraw their investments. Thus, fearing a run on the fund—and wanting to allow the SSgA funds and SSgA-advised investors to redeem their shares—Flannery allegedly set in motion a plan to sell off LDBF's highest-rated and most liquid assets in order to fund the anticipated redemptions. According to this plan, independent LDBF investors (those whose investments were not controlled by SSgA) would be encouraged to remain in the fund with the hope that the securities would recover. But, in reality, those investors would be stuck with a fund invested in illiquid, subprime bonds.

Under this theory, Flannery's participation in the July 25, 2007 Investment Committee meeting is crucial—not because it independently operated as a fraud on investors, but because it served as a backdrop against which the other violations occurred. As previously discussed, draft meeting minutes confirm that Flannery framed the committee's discussion around either (i) selling just the AAA-rated securities in the fund to satisfy redemptions, or (ii) selling "a pro-rata share" of assets across the portfolio. After debating the merits of each approach, the committee adopted a strategy that blended the two options: By the end of July 2007, they would

141 The Division does not allege that Flannery acted with scienter with respect to the August 14 letter.

increase liquidity by selling AAA-rated securities; then, as the redemptions came in, they would attempt to make pro-rata sales across the rest of the portfolio.

The record shows that, by August 2, Flannery knew that LDBF had sold approximately $1.6 billion in AAA-rated bonds, and he expected that some of the sale proceeds would be used for investor redemptions. For instance, on July 27, the head of one of SSgA's internal advisory groups informed Flannery that she would advise the group's clients to liquidate their LDBF positions by August 1. Flannery also learned by August 1 that another internal advisory group had recommended that its clients withdraw from LDBF. By August 2, redemptions by clients of both of those advisory groups were largely complete.

The Division does not allege (and the record does not suggest) that the committee's decision was itself unlawful or that the transactions involved in liquidating bonds and satisfying redemptions were improper. Rather, the Division claims that Flannery is liable for communications to LDBF investors that followed the July 25 meeting.[142]

2. The August 2 and August 14, 2007 Letters

As explained below, we find that the August 2 and August 14 letters were materially misleading, particularly when their cumulative effect is taken into account; that Flannery acted negligently when contributing to or approving the letters; and that his conduct constitutes a course of business that operated as a fraud on LDBF investors. But we find that the evidence does not establish that Flannery acted with scienter or obtained money or property by means of the letters. Accordingly, he is liable only under Section 17(a)(3).

a. The August 2 and August 14 Letters Were Misleading.

We find that the August 2 and August 14 client letters misled recipients about their investments in LDBF. When considered together—and as part of a larger effort to convince investors to remain in the poorly performing LDBF—the letters misleadingly downplayed LDBF's risk and encouraged investors to hold onto their shares, even though SSgA's own funds and internal advisory group clients were fleeing the fund.

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142 As previously noted, the Division also makes the more general allegation that Flannery "played a management role" in SSgA's "scheme" to defraud certain LDBF investors. But, as we have explained, liability under Rule 10b-5(a) and (c) and Section 17(a)(1) and (a)(3) cannot be established simply by alleging an overarching "scheme" to defraud investors; indeed, that is particularly true as to Rule 10b-5(c) and Section 17(a)(3), which do not even use the term "scheme." Rather, liability under any of these provisions can be established only through a showing of particular instances of misconduct by the defendant. *Accord, e.g.*, *SEC v. Collins & Aikman Corp.*, 524 F. Supp. 2d 477, 487 (S.D.N.Y. 2007) (explaining that alleged "participation" in a fraudulent "scheme" can suffice for liability only if the defendant made "an actual misrepresentation or [employed] a fraudulent device" and that absent "such an allegation, a claim based on mere 'participation' is legally insufficient").

i. The August 2 Letter

The August 2 letter stated, in relevant part:

> [T]he downdraft in valuations has had a significant impact on the risk profile of our portfolios, prompting us to take steps to seek to reduce risk across the affected portfolios. To date, in [LDBF], we have reduced a significant portion of our BBB-rated securities and we have sold a significant amount of our AAA-rated cash positions. Additionally, AAA-rated exposure has been reduced as some total return swaps rolled off at month end. Throughout this period, the Strategy has maintained and continues to be AA in average credit quality according to SSgA's internal portfolio analytics. The actions we have taken to date in [LDBF] simultaneously reduced risk in other SSgA active fixed income and active derivative-based strategies.

In short, this passage explains that SSgA sought to reduce LDBF's risk profile following a decline in the subprime market, and it asserts that SSgA reduced that risk, in part, by selling "a significant amount" of its "AAA-rated cash positions."[143] That statement is misleading because LDBF's sale of the AAA-rated securities did not reduce risk in the fund. Rather, the sale ultimately *increased* both the fund's credit risk and its liquidity risk because the securities that remained in the fund had a lower credit rating and were less liquid than those that were sold. Indeed, SSgA personnel acknowledged, before selling the AAA-rated securities, that with respect to LDBF this would have the effect of selling the fund's highest rated assets. Pickett, LBDF's portfolio manager, stated that selling just the AAA-rated securities would "change [LDBF's] risk profile." Others observed that selling just the AAA-rated bonds could "expos[e]" committee members "to fiduciary risk since [the sales] are changing the risk profile of [LDBF's] portfolio," that anticipated redemptions would leave LDBF with just the "illiquid" and "riskier" AA-rated investments, and that the "[w]orse [sic] case scenario" would be if SSgA's own (Related) funds exited LDBF and remaining "clients in the fund . . . suffer." Finally, Flannery himself warned other members of the Investment Committee during the July 25, 2007 meeting that if the cash raised from the sale was "siphoned" by redemptions (as they expected it to be), LDBF would be "stuck with a lower quality portfolio" that was "less liquid" and "valued less."[144]

Nevertheless, Flannery asserts that the August 2 letter was truthful, relying largely on the expert testimony of Ezra Zask, who opined that the sale of the AAA-rated securities *did* reduce the fund's risk. Critically, however, Zask's testimony assumed that the net proceeds of the sale would be held in cash or cash-equivalent securities, which are less risky than RMBS. Under this assumption, nearly every sale of assets would necessarily reduce risk. But SSgA never intended

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143 In this regard, the August 2 letter differs from the July 26 letter, which described a general strategy and did not assert that particular actions had reduced any one fund's risk profile.

144 Pickett too cautioned that "rais[ing] cash through selling the AAA" to fund redemptions would "change [LDBF's] risk profile," and others raised similar concerns. Attendees also noted that the remaining securities (the "AA component") were "very illiquid" relative to those that were sold.

to hold cash or equivalent securities; instead, it sold the AAA-rated securities to fund expected redemptions in LDBF. Indeed, by the time the August 2 letter was sent, massive outflows of the sale proceeds were already well underway to early redeemers. We therefore find Zask's comments—and Flannery's corresponding claims—about the August 2 letter not compelling.[145] Accordingly, Zask failed to rebut the Division's showing that the ultimate effect of the sales was to increase risk.

ii. The August 14 Letter

The August 14 letter stated, in part: "While we will continue to liquidate assets for our clients when they demand it, we believe that many judicious investors will hold the positions in anticipation of greater liquidity in the months to come." We find that language misleading because it suggested that SSgA viewed holding onto the LDBF investment as a "judicious" decision when, in fact, officials at SSgA had taken a contrary view, redeeming SSgA's own shares in LDBF and advising SSgA advisory group clients to redeem their interests, as well.[146]

Flannery argues that he honestly believed judicious investors would remain invested in LDBF and that such belief was reasonable. He asserts, for instance, that others at SSgA also believed "that subprime securities would recover" and that "conventional wisdom" supported holding onto the investment until the market improved. Additionally, he argues that "regardless of the reasonableness of his belief," the language in question was a "forward-looking statement of opinion" and thus "can only constitute a misrepresentation if [he] did not sincerely hold the opinion."

Those arguments fail. To begin with, Flannery's argument that his "opinion" can constitute a misrepresentation only if it was not truly held falls short. Even if Flannery, himself, believed investors should remain invested in LDBF, the statement refers to *SSgA's* belief that investors would do so. And it is undisputed that others at SSgA considered LDBF a poor investment and were exiting the fund.[147] Moreover, courts have recognized that a statement of opinion may be misleading if it "knowingly omits undisclosed facts tending seriously to

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145 We also reject Zask's assertion that the August 2 letter was not misleading because transactions other than the sales of the AAA-rated securities reduced risk in LDBF. Even if he is right about the effects of those other transactions, the August 2 letter still would have been misleading because it represented that *each* of the stated actions reduced risk, including the "s[ale] [of] a significant amount of [LDBF's] AAA-rated cash positions." Because the expected end result of that action did not reduce risk, it is irrelevant whether other transactions did.

146 We are not persuaded by the Division's other claims about why the August 14 letter was misleading.

147 In addition, we note that the cases Flannery cites in support of this argument address claims arising only under Section 10(b) and Rule 10b-5(b). Where, as here, liability is premised on an individual having engaged in a course of business that operates or would operate as a fraud, in violation of Section 17(a)(3), those cases are inapposite.

undermine the accuracy of the statement."[148] Courts have also emphasized that "professionals and others with similar access to information must disclose data that calls into question the accuracy of an opinion."[149] Here, Flannery was a securities professional who was well aware of his colleagues' negative views about LDBF. Disclosure of the SSgA-driven redemption activity unquestionably would have seriously undermined the accuracy of the statement about what "judicious investors" would do.

But Flannery disputes the need for additional disclosure, suggesting that the statement was accurate as made. He notes that it "referred to 'many,' not 'all,' judicious investors" and that some redemptions "occurred in-kind, rather than for cash," indicating that some investors did in fact want to remain invested in LDBF. Flannery also argues that the redemption activity had already been disclosed in a letter sent by SSgA on August 6 and was implicitly disclosed in the August 14 letter.

Again, we are not persuaded. First, the reference to "many," not "all," investors hardly constitutes an accurate disclosure given that the letter omits *any* recognition that many "judicious investors" (SSgA itself, as well as clients advised by SSgA) actually planned to exit (or had already exited) the fund. Second, the fact that some redemptions occurred in-kind does not justify the statement. Those investors who redeemed in-kind did so only after redeeming a large portion of their LDBF holdings for cash and after LDBF's cash largely had been exhausted. Moreover, the fact that some investors redeemed in-kind for the "assets in LDBF's *strategy*," as Flannery observes, does not establish that "judicious investors" wanted to hold onto shares of *LDBF itself*. Indeed, investors might have been wary about remaining in LDBF since, unless SSgA suspended redemptions, they would face the continuous risk that other shareholders would redeem their interests and siphon liquidity (again) from the fund. In fact, Flannery himself recognized and responded to this very problem when, in early August 2007, he created LDBF II, a monthly liquidity fund that followed the same investment strategy as LDBF but restricted redemptions, allowing investors to pursue longer-term strategies in the same assets.

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148 *Plumbers' Union Local No. 12 Pension Fund v. Nomura Asset Acceptance Corp.*, 632 F.3d 762, 775 (1st Cir. 2011) (recognizing that statement of opinion may be actionable under antifraud provisions); *In re Apple Computer Sec. Litig.*, 886 F.2d 1109, 1113 (9th Cir. 1989) (same); *Eisenberg v. Gagnon*, 766 F.2d 770, 776 (3d Cir. 1985) (same); *see also Dolphin & Bradbury*, 512 F.3d at 640-41 (finding disclosures in offering documents inadequate where professional broker-dealer omitted crucial facts from documents and "must have been aware they would mislead investors").

149 *Kline v. First W. Gov. Sec., Inc.*, 24 F.3d 480, 487 (3d Cir. 1994); *cf. Dolphin & Bradbury*, 512 F.3d at 640-41 (noting that defendant, "an experienced professional" had a duty to disclose "unusually important" information to investors in marketing materials (internal quotation marks omitted)); *Eisenberg*, 766 F.2d at 776 (noting that for representations "made by professionals or those with greater access to information or having a special relationship to investors," there is "an obligation to disclose data indicating that the opinion or forecast may be doubtful" (internal quotation marks omitted)).

Finally, we are not convinced that the redemption activity was adequately disclosed in either the August 6 or August 14 letter. The August 6 letter to which Flannery refers disclosed only that "[c]ertain SSgA" internal advisory groups "intend[ed] to redeem in-kind" their shares in LDBF—it did not reveal that those investors had *already* redeemed a large portion of their LDBF holdings for cash. Similarly, the oblique statement in the August 14 letter to which Flannery points—that SSgA would "continue to liquidate assets for [its] clients"—hardly constitutes a disclosure about the magnitude of the redemptions and implications for remaining investors.

b. The Misrepresentations in the Letters Were Material.

We find that the misstatements and omissions in the August 2 and August 14 letters were material. It would have significantly altered the total mix of information available to a reasonable investor had those letters disclosed the truth about (i) the ultimate impact of the sale of AAA-rated securities on LDBF's risk profile, and (ii) the fact that SSgA's own funds and SSgA-advised investors fled the fund in late July and early August.[150] Disclosure of either fact would have undercut especially Flannery's prediction in the August 14 letter that many judicious investors would continue to hold LDBF in the hope of a future recovery.

Flannery disputes the materiality of the challenged statements by arguing (like Hopkins) that the materiality analysis should take into account the sophistication of actual LDBF investors. For the reasons previously discussed, however, the materiality inquiry turns on the significance of misrepresentations to an *objective* "reasonable investor," not the particular individuals in question.[151] And, as also discussed previously, even if we were to conduct the sort of materiality analysis Flannery insists is appropriate, we find that LDBF's investors still would have wanted to know the facts that SSgA failed to disclose because those investors (and the consultants they employed) were not necessarily uniformly knowledgeable about fixed income investing.

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150 *See generally SEC v. Fife*, 311 F.3d 1, 10 (1st Cir. 2002) (finding that misrepresentations and omissions regarding risk were material "because a reasonable investor would want to know the risks involved" in program at issue); *see also Fundamental Portfolio Advisors*, 2003 WL 21658248, at *12 ("A reasonable investor would have considered it important that the Fund was changing its portfolio from one predominately invested in the low risk securities described in the 1993 prospectus and sales literature to a portfolio with a substantial portion of the Fund's assets in CMOs that were highly exposed to interest rate risks and, thus, were highly volatile."); *cf. Freudenberg*, 712 F. Supp. 2d at 182-84 (as pleaded, misrepresentations relating to portfolio risk profile were material); *In re MoneyGram Int'l, Inc. Sec. Litig.*, 626 F. Supp. 2d at 978 (as pleaded, concealment of information relating to portfolio risk were material).

151 *See Amgen*, 133 S. Ct. at 1195; *Matrix Initiatives*, 131 S. Ct. at 1321-22; *Basic*, 485 U.S. at 231-32, 240 & n.18; *TSC Indus.*, 426 U.S. at 445.

c. Flannery Acted with Negligence, But Not Scienter, with Respect to the August 2 and August 14 Letters.

The Division argues that Flannery was, at minimum, negligent with respect to his contributions to and approval of the August 2 and 14 letters. The record supports that claim. We find that Flannery was aware of the facts that made the letters misleading at the time they were finalized but nevertheless failed to correct the misleading statements or disclose the facts that would have given investors a correct impression about LDBF. We find, however, that Flannery did not act with scienter with regard to the August 2 letter, as the Division alleges.[152]

First, the record does indicate (and the Division effectively has conceded) that, on August 2, Flannery did in fact believe that LDBF's portfolio risk had been reduced. While Flannery's subjective state of mind is not dispositive to a finding that he lacked scienter, it is nevertheless relevant that he apparently did not fully appreciate the gravity of the risk that the August 2 letter would mislead investors.[153] Moreover, we find that the danger of misleading investors was not so obvious that Flannery "must have been" aware of it.[154] Accordingly, we cannot conclude that Flannery demonstrated extreme recklessness in approving the August 2 letter.[155]

Nonetheless, we find that Flannery *should* have been aware of the risk the letter posed, and thus his conduct was negligent under the circumstances. As noted, Flannery was aware that if the SSgA funds and SSgA-advised investors chose to redeem their shares, then the sale of the AAA-rated securities would leave LDBF with a "lower quality portfolio." Further, he knew that the very purpose of the sale was to generate liquidity for expected redemptions. He thus should have appreciated that the sale would increase risk for remaining investors, and that there was a significant danger that, as drafted, the August 2 letter would mislead investors.

We find particularly compelling, with respect to the August 2 letter, Flannery's acknowledgment at the Investment Committee meeting that, if "liquidity [were] siphoned" following the sale of the AAA-rated securities, LDBF would be "stuck with a lower quality portfolio." That statement demonstrates Flannery's understanding that, practically speaking, those sales—which were in fact immediately followed by massive redemptions—*did* adversely affect LDBF's risk profile. His subsequent approval of the statement in the August 2 letter that the sales *reduced* risk thus reflects a departure from the "reasonable care" he owed LDBF investors. And his conduct with respect to the August 14 letter evinces only a further departure from that standard: He represented that investing in LDBF was still a "judicious" decision, thereby compounding the likelihood that investors would be misled.

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152 The Division does not allege that Flannery acted with scienter with respect to the August 14 letter.

153 *See SEC v. Platforms Wireless Intern. Corp.*, 617 F.3d 1072, 1093-94 (9th Cir. 2010).

154 *See id.; see also supra* note 24.

155 Flannery therefore is not liable under Rule 10b-5 or Section 17(a)(1). *See Aaron*, 446 U.S. at 697 (scienter required under Section 17(a)(1)); *Hochfelder*, 425 U.S. at 193, 214 (scienter required under Rule 10b-5).

Flannery's principal challenge to a finding of negligence is that he reasonably relied on the involvement of counsel when editing and approving both letters. But even accepting Flannery's claims that counsel were heavily involved in the drafting of the letters, that does not make his approval and/or drafting of the challenged language reasonable under the circumstances.[156] That is because whether those particular statements were true was not a legal judgment but a business one—and one that Flannery was well equipped to make.[157] Moreover, Flannery was well aware of the facts that rendered the statements at issue misleading.[158] With regard to the August 2 letter, Flannery did not have to be an attorney to understand that the sale of AAA-rated securities, followed by massive redemptions, ultimately increased LDBF's risk. Indeed, he himself made this very observation at the Investment Committee meeting. Nor did he need legal training to understand with regard to the August 14 letter that, in truth, "judicious investors" thought it best to exit the fund, as his own colleagues had told him that they would be advising their clients to redeem their LDBF shares.

Flannery offers several additional reasons why his actions with regard to each letter were not negligent; we briefly address, but reject, those arguments. First, as to the August 2 letter,

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156 As at least one appellate court has recognized, reliance on counsel does not preclude a finding of negligence, which is an objective, not subjective, inquiry. *See Howard v. SEC*, 376 F.3d 1136, 1147-49 (D.C. Cir. 2004) (finding, despite a reliance on counsel defense, that the defendant nevertheless may have been negligent for failing to make certain disclosures that he arguably "should have" known were required); *Steadman*, 967 F.2d at 642 (finding, despite a reliance on counsel defense, that the defendants nevertheless may have been negligent for failing to disclose the lack of registration in their financial statements). And, even in cases of legal judgments, courts generally agree that reliance on counsel "is not a complete defense, but only one factor for consideration." *E.g.*, *Markowski v. SEC*, 34 F.3d 99, 105 (2d Cir. 1994); *Howard*, 376 F.3d at 1147-48.

157 That the judgments at issue were not the sort typically delegated to attorneys even further distinguishes this case from others in which the advice of counsel (or another professional) has been found to negate liability. *Compare, e.g.*, *Howard*, 376 F.3d at 1147-48 (finding scienter lacking where defendant relied on the advice of counsel in interpreting a Commission rule that was itself silent as to the particular transactions at issue and whose interpretive guidance even admitted that the law applicable to those transactions was unclear).

158 *Cf. Pittsburgh Terminal Corp. v. Balt. & Ohio R.R. Co.*, 680 F.2d 933, 943 (3d Cir. 1982) (rejecting reliance-on-counsel defense where defendants "know the materiality of the concealed information and intend the consequences of concealment"); *United States v. King*, 560 F.2d 122, 132 (2d Cir. 1977) ("[S]ignificant representations were made as to specific facts . . . [and] we cannot understand how a businessman who knows that such factual representations are untrue can screen himself by trying to rely on advice of counsel."); *Dolphin & Bradbury*, 512 F.3d at 642 (noting, in part, that where petitioner "could not have had a genuine belief in" his statements' "completeness and accuracy," he could not rely on a reliance-on-counsel argument to negate scienter); *SEC v. Goldfield Deep Mines Co. of Nev.*, 758 F.2d 459, 467 (9th Cir. 1985) (reliance-on-professional defense not available where defendants "knew" that statements made in public filings "were false or misleading").

Flannery contends that: (i) he believed in good faith the statement about the reduction in LDBF's risk; (ii) he suggested edits that would have enhanced the letter's accuracy; (iii) others at SSgA "were heavily involved in reviewing and editing the letter," whereas he had a more limited role; and (iv) he "was not a 'final approver' of the letter."

As indicated above, Flannery's "good faith" belief in the letter's accuracy may be relevant to his lack of scienter, but it is not relevant to whether he should have known the letter was misleading. As for Flannery's other arguments, even if he did suggest minor edits to the letter that were never incorporated, and even if others were "heavily involved" in its drafting, we find that those facts also do not excuse his decision to approve misleading language. Regardless of what others may have thought, he had an obligation to exercise his own, independent, judgment.[159] Moreover, whether or not Flannery lacked final approval authority, we find it sufficient that he was sent a draft of the August 2 letter, edited it, and made no changes to the language we find misleading. He was also copied on the final version that was to be sent to clients. Flannery was a senior official at SSgA, and his repeated decisions not to change the language at issue operated as tacit approval of its contents.

As for the August 14 letter, Flannery contends that several factors preclude a finding of negligence: (i) in-house counsel Duggan "was responsible for adding the 'judicious investors' language" to the letter; (ii) "Duggan and other SSgA attorneys, as well as . . . other senior executives, were heavily involved in reviewing and editing the letter, and none of them told Flannery that the letter was misleading"; and (iii) "Flannery understood that all of these people were armed with complete information about LDBF's situation."[160]

The record shows that, regardless of contributions by others, *Flannery* specifically intended the letter to encourage outside investors to remain in LDBF. His initial draft expressly "advi[sed]" investors "to hold the positions [in LDBF] for now." Duggan revised this language to read "we believe that many judicious investors will hold the positions in anticipation of greater liquidity in the months to come." But Flannery approved the change, having concluded that (according to his testimony) the "judicious investors" edit did not "materially change" the message in his initial draft. He agreed that the revision still expressed to SSgA clients "a negative view on selling their investments in [LDBF] at the time of the letter." We thus find it irrelevant that Duggan proposed the precise language at issue, because Flannery knew that the language would discourage investors from selling their shares in LDBF, as he intended.

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159 *Cf. Goldfield Deep Mines Co.*, 758 F.2d at 467 ("If a company officer knows that the financial statements are false or misleading and yet proceeds to file them, the willingness of an accountant to give an unqualified opinion with respect to them does not negate the existence of the requisite intent or establish good faith reliance." (*quoting United States v. Erickson*, 601 F.2d 296, 305 (7th Cir. 1979))).

160 To the extent Flannery also argues that he cannot be found negligent because he sincerely believed the "many judicious investors" statement, we reject that claim as well. We find it dubious that he actually believed the statement, and, in any event, we find such a belief unreasonable given Flannery's knowledge at the time that SSgA itself and its internal advisory group clients were redeeming shares in the fund.

We find it similarly irrelevant that others at SSgA reviewed the August 14 letter and did not tell Flannery that it was misleading. Whatever others may have thought (or said aloud to Flannery), Flannery still should have appreciated that the letter was misleading. Again, the fact that others (including attorneys) apparently sanctioned the language does not excuse Flannery's decision to do so.[161] Indeed, the record shows that the attorneys on whom Flannery contends he relied in fact relied on *Flannery* and the investment team to confirm the factual statements in investor communications. For instance, as one in-house attorney explained with respect to the August 2 letter, he reviewed a draft "for clarity," but he accepted on faith its factual statements, because it was "prepared by [SSgA's] most senior level investment people and . . . there was nothing to lead [him] to believe that the facts weren't anything other than as they were set [] forth" in the draft.

For all of these reasons, we find that Flannery was negligent in drafting, editing, and approving the August 2 and 14 letters.

d. Flannery Did Not "Obtain Money or Property by Means of" the Misrepresentations in the August 2 and August 14 Letters.

The Division argues that Flannery "obtain[ed] money or property by means of" the August 2 and August 14 letters because the letters were "used" to mislead investors, and, after the letters were sent, "independent investors made purchases in LDBF." But, as previously explained, we read Section 17(a)(2) to require more than a mere temporal connection between a misrepresentation and the acquisition of money or property. Because the Division has failed to show any *causal* link between the letters and Flannery's (or SSgA's) acquisition of money or property, we find Flannery not liable under Section 17(a)(2).[162]

e. Flannery's Conduct with Respect to the August 2 and August 14 Letters Constitutes a "Course of Business" that Operated as a Fraud on LDBF Investors.

We find that Flannery's conduct with respect to the August 2 and August 14 letters violated Section 17(a)(3). As discussed above, Flannery helped to draft, edit, and approve at

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161 *Cf. Goldfield Deep Mines Co.*, 758 F.2d at 467.

162 As it did with respect to Hopkins, the Division arguably asserts that SSgA and Flannery "obtained money or property" by inducing investors who otherwise would have redeemed their shares in LDBF to remain in the fund. But the Division fails to explain how such a claim would satisfy the requirement that Flannery obtain money or property because of his alleged misrepresentations and did not pursue this theory at oral argument. In addition, as previously noted with respect to Hopkins, at oral argument counsel for the Division suggested that Flannery's receipt of salary and/or bonus payments during the course of his employment might satisfy the "obtained money or property" requirement, on the theory that Flannery successfully "obtained" money for his employer, some of which it passed on to him. But assuming such a standard applies, the Division failed to explain how, if at all, State Street's receipt of money or property was tied to, or dependent upon, Flannery's alleged misconduct.

least two letters that had the cumulative effect of misleading LDBF investors about their investments. His negligent conduct spanned a critical two-week period of market turmoil and encompassed more than one materially misleading communication. We find this sufficient to hold Flannery liable for having engaged in a "course of business" that operated as a fraud on LDBF investors.[163]

V.

A. Fair Notice of Claims Under Rule 10b-5(a) and (c) and Section 17(a)(1) and (a)(3)

Flannery contends that the Division's claims under Rule 10b-5(a) and (c) and Section 17(a)(1) and (a)(3) must be dismissed because he was denied fair notice of those claims. He contends that the OIP did not "describe how [he] allegedly engaged in a scheme to defraud," and the Division also failed to "articulate its theories" in subsequent proceedings. We disagree.

First, we find that the OIP adequately alerted Flannery that the proceedings would consider whether he engaged in a fraudulent course of business. It specifically alleged that he "engaged in a course of business and made material misrepresentations and omissions that misled investors about the extent of subprime mortgage-backed securities held in certain unregistered funds under State Street's management."[164] And it repeatedly invoked the language of the relevant statutory and regulatory provisions, charging Flannery with, among other things, having "engaged in . . . courses of business . . . that operated or would operate as a fraud or deceit upon the purchasers of such securities."[165]

The OIP also made factual allegations in support of those claims. It alleged that Flannery "played an instrumental role in drafting the misrepresentations" made to investors in July and August 2007.[166] And, after describing the July 25 Investment Committee meeting, the OIP stated that "Flannery's involvement in [that] discussion, his awareness of the Fund's holdings, and his expertise concerning the market conditions for the Fund's assets put him in a unique position to understand that the Investment Committee's decision put investors who remained in the Fund at greater risk after the anticipated redemptions were satisfied."[167] The OIP also detailed Flannery's involvement in the August 2 and August 14 letters to investors.[168] We find

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163 Because we find Flannery negligent, we need not consider whether a violation of Section 17(a)(3) could lie absent a showing of negligence. *See supra* note 30.

164 OIP, 2010 WL 3826277, at *1. The OIP also put Flannery on notice that the proceedings would consider whether he employed "devices," "schemes," and "artifices" to defraud, though that issue is rendered moot by our determination that he is liable only under Section 17(a)(3). We also do not address Flannery's contention that the OIP was deficient in its failure to mention the July 26 letter, since we find him not liable with respect to that letter.

165 *Id.* at *13.

166 *Id.* at *2, *8.

167 *Id.* at *11.

168 *Id.* at *12.

these allegations sufficient to inform Flannery "of the charges in enough detail to allow [him] to prepare a defense."[169]

Moreover, we note that even if the OIP were ambiguous in the manner Flannery suggests, that would not justify dismissal of the Section 17(a)(3) claim for which we find him liable. In administrative proceedings, the standard for determining whether notice is adequate is whether "the respondent understood the issue and was afforded full opportunity to justify [his] conduct during the course of the litigation."[170] "Thus, the question on review is not the adequacy of the [OIP] but is the fairness of the whole procedure."[171] Here, the record shows that Flannery (and his counsel, who represented him throughout the proceeding) adequately understood the nature of the Division's claims and had ample opportunity to defend against them. It is especially telling that both Flannery and the Division filed multiple letters with the law judge addressing the scope of "scheme" and "course of business" claims following the Supreme Court's decision in *Janus* and a subsequent district court decision.[172] Those letters demonstrate that Flannery was aware that the Division intended to argue that he was liable under Section 17(a)(3).[173]

B. Preservation of Issues Raised on Appeal

Hopkins and Flannery assert that many of the Division's arguments on appeal go beyond the issues raised in its petition for review and therefore are not properly before us. According to Hopkins, the Division ignores Commission Rules of Practice 410(b) and 411(d), which require that the petition "set forth specific findings . . . as to which exception is taken" and limit Commission review to issues specified in the petition.[174] Flannery also suggests that we should defer to the law judge's factual findings.

While it is true that the Division's petition does not articulate extensive specific challenges to the Initial Decision, the petition *does* state that the Division seeks review of the law

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169 *McConville*, 2005 WL 1560276, at *14 (noting also that the OIP "need not disclose to the respondent the evidence upon which the Division intends to rely").

170 *Aloha Airlines, Inc. v. Civil Aeronautics Bd.*, 598 F.2d 250, 262 (D.C. Cir. 1979) (internal quotation marks omitted); *accord Flying Food Grp., Inc. v. NLRB*, 471 F.3d 178, 183-84 (D.C. Cir. 2006); *Clawson v. SEC*, No. 03-73199, 2005 WL 2174637, at *1 (9th Cir. Sept. 8, 2005).

171 *Aloha Airlines*, 598 F.2d at 262 (internal quotation marks omitted); *James L. Owsley*, Exchange Act Release No. 32491, 51 SEC 524, 1993 WL 226056, at *4 (June 18, 1993) (recognizing that a defect in an administrative pleading can be remedied if the record shows that the respondent understood the issue and was afforded a sufficient opportunity to justify his conduct).

172 *See Flannery*, 2011 WL 5130058, at *34-35.

173 We note as well that Flannery has not asserted that he suffered prejudice as a result of the supposed lack of notice. He has not identified any additional evidence or defenses he would have proffered had he better understood the charges against him. *See Aloha Airlines*, 598 F.2d at 262; *Clawson*, 2005 WL 2174637, at *1.

174 17 C.F.R. §§ 201.410(b), 201.411(d).

judge's findings that: (i) Hopkins did not violate Section 17(a), Section 10(b), and Rule 10b-5, and (ii) Flannery did not violate Section 17(a), Section 10(b), and Rules 10b-5(a) and (c).[175] The Petition also broadly disputes the Initial Decision's findings of fact, stating, the "Division takes exception to many of the findings in the Initial Decision, including the misapplication of *Janus*."[176] We find these challenges sufficient to render the issues raised in the Division's briefs properly before us. Moreover, our *de novo* review of the decision below affords us broad authority to consider all aspects of this case on appeal.[177] Finally, we note that neither Flannery nor Hopkins suggests that he was denied an adequate opportunity to prepare a response to the Division's appeal, nor is there any other apparent basis for such a finding. Thus, due process concerns do not limit the scope of our review.[178]

VI.

As to both Flannery and Hopkins, the Division seeks (i) a suspension or bar from association with investment advisers and investment companies under Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") and/or Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act"); (ii) a cease-and-desist order under Section 8A of the Securities Act and/or Section 21C of the Exchange Act; and (iii) civil penalties under Section 8A of the Securities Act, Section 21B(a) of the Exchange Act, Section 203(i) of the Advisers Act, and/or Section 9(d) of the Investment Company Act.[179]

A. Suspensions or Bars

To impose a suspension or bar from association with investment advisers or investment companies under Section 9(b) of the Investment Company Act as a remedy for their Securities Act and/or Exchange Act violations, we must find that (i) Hopkins and Flannery willfully

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175 Petition at 2.

176 *Id.* at 3.

177 *Gary M. Kornman*, Investment Advisers Act Release No. 2840, 2009 WL 367635, at *9 n.44 (Feb. 13, 2009) (noting that the Commission's review of a law judge's opinion is *de novo*); *see also Gregory M. Dearlove, CPA*, Exchange Act Release No. 57244, 2008 WL 281105, at *10 n.42 (Jan. 31, 2008) ("The law judge's opinion ceased to have any force or effect once [petitioner] filed his petition for review."); *Fundamental Portfolio Advisors*, 2003 WL 21658248, at *13 n.44 (same); *see generally Rules of Practice*, 1995 WL 368865, at *83 ("On appeal from or review of the initial decision, the agency has all the powers which it would have in making the initial decision except as it may limit the issues on notice or by rule." (quoting 5 U.S.C. § 557(b)).

178 *Cf. Aloha Airlines*, 598 F.2d at 262 (stating that the standard for whether notice is adequate is whether "the respondent understood the issue and was afforded full opportunity to justify [his] conduct during the course of the litigation" (internal quotation marks omitted; alteration in original)).

179 OIP, 2010 WL 3826277, at *13-14.

violated the Securities Act or the Exchange Act, and (ii) the sanction is in the public interest.[180] To impose a suspension or bar from association with investment advisers under Section 203(f) of the Advisers Act as a remedy for their respective violations, we must find that the two above criteria are satisfied and, in addition, that Hopkins and Flannery were "person[s] . . . associated with an investment adviser" during the relevant period.[181] As discussed below, we find that all of these criteria are satisfied and, accordingly, impose one-year suspensions on both Hopkins and Flannery under the Investment Company Act and the Advisers Act.

1. Respondents Willfully Violated the Securities Laws.

In the context of securities laws violations, the term "willfully" means merely "that the person charged with the duty knows what he is doing."[182] It is sufficient that the actor "intentionally" or "voluntarily" committed the act that constitutes the violation; he need not also be aware that he is violating one of the securities laws or rules promulgated thereunder.[183] Here, we find that Hopkins "willfully" violated the Securities Act and the Exchange Act, and Flannery "willfully" violated the Securities Act. Although they contest their violations, neither respondent seriously contests a finding of willfulness, and the record gives no indication they did not intentionally and voluntarily engage in the conduct for which we hold them liable.

2. Suspensions Are in the Public Interest.

When determining whether remedial action is in the public interest, we consider: the egregiousness of the respondent's actions, the isolated or recurrent nature of the infraction, the degree of scienter involved, the sincerity of the respondent's assurances against future violations, the respondent's recognition of the wrongful nature of his or her conduct, and the likelihood that the respondent's occupation will present opportunities for future violations.[184] Our inquiry is flexible, and no one factor is dispositive.[185] Also, we note that the remedy is intended to "protect[] the trading public from further harm," not to punish the respondent.[186]

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180 *See* 15 U.S.C. § 80a-9(b).

181 *See id.* § 80b-3(e)(5), (f).

182 *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000) (internal quotation marks omitted); *Jason A. Craig*, Exchange Act Release No. 59137, 2008 WL 5328784, at *4 (Dec. 22, 2008).

183 *Wonsover*, 205 F.3d at 414; *accord Mathis v. SEC*, 671 F.3d 210, 217 (2d Cir. 2012); *Decker v. SEC*, 631 F.2d 1380, 1386 (10th Cir. 1980); *Jason A. Craig*, 2008 WL 5328784, at *4.

184 *See Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981).

185 *David Henry Disraeli*, Exchange Act Release No. 57027, 2007 WL 4481515, at *15 (Dec. 21, 2007), *aff'd*, 334 F. App'x 334 (D.C. Cir. 2009) (per curiam).

186 *McCarthy v. SEC*, 406 F.3d 179, 188 (2d Cir. 2005); *see also Paz Sec., Inc. v. SEC*, 566 F.3d 1172, 1175-76 (D.C. Cir. 2009).

We find that it is in the public interest to suspend Hopkins and Flannery from associating with investment advisers or investment companies for one year. As to Hopkins, his conduct in violation of Section 17(a)(1) and Rule 10b-5 was an abuse of his responsibilities as a securities professional. He has refused to acknowledge the wrongful nature of that conduct; indeed, he has consistently insisted that he acted in the best interests of LDBF investors. He also has made no assurances against future violations. Thus, we are concerned that Hopkins will commit future violations of the securities laws and present a danger to investors if not subjected to a suspension.

As to Flannery, although he did not act with scienter, his misconduct spanned more than one communication and thus cannot be seen as a single lapse in judgment. He was a senior SSgA official responsible for client investments who, like Hopkins, abused his professional responsibilities. Moreover, Flannery too has never acknowledged the wrongful nature of his conduct or made assurances against future violations. Thus, we are similarly concerned about protecting investors from future violations and impose a one-year suspension.[187]

In reaching this determination, we have considered factors that Respondents contend are mitigating. They argue, for instance, that the Division failed to show how many, or to what extent, investors were harmed by their actions.[188] But the Division is not required to establish reliance or loss by any investor,[189] and our decision that suspensions are warranted is not premised on investors having suffered financial losses. Respondents also note that they were not shown to have benefited personally from the fraud. But that is not a requirement for imposing a suspension and, in any event, we find that their misconduct was (at the very least) in furtherance of their lucrative careers as securities professionals. Finally, Respondents emphasize that they have had long careers as securities professionals without any prior disciplinary history. We have considered that fact in finding that it is in the public interest to impose the relatively lenient sanction of a one-year suspension as to both Hopkins and Flannery.

3. Respondents Were Associated with an Investment Adviser.

Under the Advisers Act, the term "person associated with an investment adviser" means: "[A]ny partner, officer, or director of such investment adviser (or any person performing similar functions), or any person directly or indirectly controlling or controlled by such investment adviser, including any employee of such investment adviser."[190] For purposes of determining

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187 *Cf. IMS/CPAs & Assoc.*, Advisers Act Release No. 8031, 2001 WL 1359521, at *12 (Nov. 5, 2001) (imposing suspensions on persons associated with an investment adviser who committed antifraud violations by failing to disclose to their clients their receipt of compensation in return for making investment recommendations), *petition denied sub nom. Vernazza v. SEC*, 327 F.3d 851 (9th Cir. 2003).

188 At oral argument, counsel for Flannery and Hopkins noted that the Division presented only a single witness, Hammerstein, to testify about the effect of the alleged fraud on investors.

189 *See, e.g., Morgan Keegan & Co.*, 678 F.3d at 1244; *Graham v. SEC*, 222 F.3d 994, 1001 n.15 (D.C. Cir. 2000).

190 15 U.S.C. § 80b-2(a)(17).

whether a suspension or bar may be imposed under Section 203(f), the definition of "associated" persons is quite broad; it includes even those "whose functions are clerical or ministerial."[191] We find that both Hopkins and Flannery were persons associated with a registered investment adviser.

As a bank, State Street is excluded from the definition of investment adviser in the Advisers Act.[192] And, as previously noted, SSgA is not itself a legal entity; it is merely an operating division of State Street Corporation. But State Street Corporation has (and had in 2006 and 2007) a separate registered investment subsidiary, SSgA Global Funds Management Inc. ("SSgA FM"), that is (and was in 2006 and 2007) the registered investment adviser for mutual funds registered under the Investment Company Act.[193]

Flannery testified that, when he served as CIO of the Americas at SSgA, he directly supervised portfolio managers for some of the registered funds managed by SSgA FM. In addition, Flannery was a member of SSgA's Investment Committee; according to the SSgA Funds' prospectus, that committee was responsible for overseeing all of the portfolio management teams at SSgA FM, including the teams responsible for the registered funds. That evidence is sufficient to establish that Flannery was "associated with" SSgA FM: By supervising SSgA FM portfolio managers responsible for registered funds, he was, at minimum, performing functions similar to those of a partner, officer, or director of an investment adviser and was "directly or indirectly controlling" SSgA FM and its employees.

According to Hopkins's testimony, he served as a product engineer for certain of SSgA FM's registered funds (in addition to serving as a product engineer for certain unregistered funds, such as LDBF). And when the responsibility for working with the registered funds passed to another individual, he served as that person's supervisor. That is sufficient to establish that Hopkins was "associated with" SSgA FM. As he himself explained, his responsibilities as a product engineer included advising clients directly about how funds were managed and assisting portfolio managers by explaining their strategies to client-facing personnel. These activities, when performed on behalf of SSgA FM's registered funds, were central to the funds' operations and made him an integral member of the investment and client management teams. They place him well within the definition of "associated" persons under the Advisers Act.[194]

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191 *Id.*

192 *See id.* § 80b-2(a)(11).

193 *See generally id.* § 80a-8.

194 *See, e.g.*, *Michael Batterman*, Investment Advisers Act Release No. 2334, 57 SEC 1031, 2004 WL 2785527, at *3-4 (Dec. 3, 2004) (noting that the Commission may "discipline a person associated with an investment adviser even if that person is associated only in a clerical or ministerial capacity" and finding that respondent's associated activities exceeded that standard, as he was "part of the team" responsible for client investments and his role was "important to the fund's operations"); *see also SEC v. Householder,* No. 02-4128, 2002 WL 31207292, at *5 (N.D. Ill. Oct. 1, 2002) (individual with an "integral" role in "running" investment company was "associated with an investment adviser").

B. Cease-and-Desist Orders

Section 8A of the Securities Act and Section 21C of the Exchange Act authorize us to issue a cease-and-desist order against any person who "has violated" those statutes or rules thereunder.[195] When determining whether such an order is appropriate, we consider public interest factors that are substantially the same as those we consider when imposing a suspension or bar.[196] "In addition, we consider whether the violation is recent, the degree of harm to investors or the marketplace resulting from the violation, and the remedial function to be served by the cease-and-desist order in the context of any other sanctions being sought."[197] Again, this inquiry is flexible, and no single factor is dispositive.[198] Evidence of a past violation ordinarily suffices to establish a risk of future violations, absent evidence to the contrary.[199]

Here, we find that Respondents' respective past violations of the securities laws demonstrate a risk of future violations. We note, as well, the seriousness of their misconduct and each Respondent's failure to appreciate his responsibilities as a securities professional. Accordingly, we find sufficient risk that Hopkins and Flannery will commit future violations to warrant our imposition of a cease-and-desist order as to each.

C. Civil Penalties

1. Authority to Impose Civil Penalties

Both Hopkins and Flannery contend that imposing civil penalties in this case would entail improper retroactive application of Section 929P(a) of the 2010 Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") because the conduct for which they are

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195 15 U.S.C. § 77h-1(a) (Securities Act); *id.* § 78u-3(a) (Exchange Act).

196 *See Joseph J. Barbato*, Exchange Act Release No. 41034, 53 SEC 1259, 1999 WL 58922, at *14 n.31 (Feb. 10, 1999). For instance, we consider the seriousness of the violation, the isolated or recurrent nature of the violation, the respondent's state of mind in committing the violation, the sincerity of assurances against future violations, the respondent's recognition of the wrongful nature of the conduct, and the respondent's opportunity to commit future violations. *KPMG Peat Marwick LLP*, Exchange Act Release No. 43862, 54 SEC 1135, 2001 WL 47245, at *26 (Jan. 19, 2001), *pet. denied*, 289 F.3d 109 (D.C. Cir. 2002).

197 *KPMG Peat Marwick*, 2001 WL 47245, at *26.

198 *Id.* at *24, *26.

199 *See Schoemann v. SEC*, 398 F. App'x 603, 604 (D.C. Cir. 2010) (per curiam) (affirming the imposition of a cease-and-desist order because petitioner's conduct "constituted a violation of the [Securities] Act") *aff'g* Securities Act Release No. 9076, 2009 WL 3413043, at *12-13 (Oct. 23, 2009) (noting that "absent evidence to the contrary, a single past violation ordinarily suffices to raise a sufficient risk of future violations"); *cf. KPMG Peat Marwick*, 2001 WL 47245, at *24, *26 (finding that a cease-and-desist order may be imposed only where there is some risk of future violations, but that the risk "need not be very great").

charged occurred before the statute was enacted.[200] They are mistaken. As discussed below, although the Dodd-Frank Act did grant us new authority to impose penalties in some cases, this is not such a case. Rather, our authority to impose penalties here derives from provisions of the Advisers Act and the Investment Company Act that were in effect when the violative conduct occurred.[201]

Section 929P(a) amended the Securities Act, Exchange Act, Advisers Act, and Investment Company Act, in part, by authorizing the Commission to impose monetary penalties in administrative cease-and-desist proceedings brought under those statutes. As Respondents note, before the provision was enacted, the Division could not have obtained penalties against Hopkins or Flannery in administrative proceedings brought under the Securities Act or the Exchange Act. The Securities Act did not authorize the imposition of civil penalties in any administrative proceedings. And the Exchange Act authorized penalties only in actions against those registered under its provisions; as to others, such as Hopkins and Flannery, the Division could obtain monetary relief only in actions brought in federal court.

But the Advisers Act and the Investment Company Act were not so limited. Even before Dodd-Frank was enacted, both statutes authorized us to impose penalties in administrative suspension proceedings, even though we could not do so in administrative cease-and-desist

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200 *See* Pub. L. No. 111-203, 124 Stat. 1376, 1862-65 (July 21, 2010).

201 We therefore need not address Respondents' claim that it would be improper to impose penalties here under Section 929P(a)'s amendments to the Securities Act or the Exchange Act. Nonetheless, we note that we are not persuaded by their argument that reliance on Section 929P(a) here to impose penalties would violate the presumption against retroactive legislation. We read the Supreme Court's decisions in *Landgraf v. USI Film* Products, 511 U.S. 244, 273-74 (1994), and *Hallowell v. Commons*, 239 U.S. 506, 508 (1916), to indicate that Section 929P(a) is precisely the sort of forum-shifting legislation that *may* be applied to pre-enactment conduct notwithstanding the presumption against retroactive legislation. Section 929P(a)'s amendments to the Securities Act and the Exchange Act merely establish a new forum in which the Division may bring certain claims for monetary relief—but such relief was already available to the Division in actions brought in federal court. Moreover, we find the authority Respondents cite on this issue inapposite. Both *Molosky v. Washington Mutual, Inc.* and *SEC v. Daifotis* address entirely separate provisions of the Dodd-Frank Act; whether *those* provisions may be applied retroactively has no bearing on the scope of Section 929P(a). *See Molosky*, 664 F.3d 109, 113 n.1 (6th Cir. 2011) (stating that provisions regarding federal preemption of state banking laws had "no retroactive effect"); *Daifotis*, 2011 WL 2183314, at *12-14 (holding that provision authorizing the Commission to bring new aiding and abetting claims under the Investment Company Act, could not be applied retroactively because it "created jurisdiction where none previously existed[,] . . . increased the extent of liability," and "eliminated defenses" available to defendants); *see also Landgraf*, 511 U.S. at 280 (rejecting notion that "diverse provisions of [a statute] must be treated uniformly for [retroactivity] purposes"). And in *Gupta v. SEC*, the court speculated about the possible retroactive application of Section 929P(a), but it did not give serious consideration to the question, let alone hold that it would be improper to apply the provision in a case like this one. 796 F. Supp. 2d 503, 507 (S.D.N.Y. 2011).

proceedings.[202] Because this is, in part, a suspension proceeding brought under the applicable provisions of the Advisers Act and the Investment Company Act, we are well within our authority to impose penalties against Hopkins and Flannery here, even without invoking the additional authority granted to us by Section 929P(a) of the Dodd-Frank Act.

2. Appropriate Penalties

In proceedings under Section 203(f) of the Advisers Act and Section 9(b) of the Investment Company Act, penalties are warranted only if we find that Hopkins and Flannery willfully violated the securities laws and that imposing penalties would be in the public interest.[203] As discussed above, we find that both Hopkins and Flannery acted willfully when committing their respective violations. To determine whether imposing penalties would be in the public interest, we consider (i) whether the act or omission involved fraud, (ii) whether the act or omission resulted in harm to others, (iii) the extent to which any person was unjustly enriched, (iv) whether the individual has committed previous violations, (v) the need to deter such person and others from committing violations, and (vi) such other matters as justice may require.[204] We may assess separate penalties "for each act or omission" in violation of the federal securities laws; those penalties fall into three tiers, depending on the nature of the violation.[205] As relevant here, we may impose first-tier penalties of up to $6,500 for violations of the securities laws and second-tier penalties of up to $65,000 for violations that "involved fraud, deceit, manipulation, or deliberate or reckless disregard of a regulatory requirement."[206]

We find that Hopkins committed at least one violation of the securities laws based on the misrepresentation he made during his May 10, 2007 presentation to National Jewish using the Typical Portfolio Slide. Because he acted with scienter in violating Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act, and Rule 10b-5, we find that, at minimum, he demonstrated "reckless disregard of a regulatory requirement." Moreover, Hopkins's conduct created a substantial risk of harm to investors who remained invested in LDBF without a full understanding of the extent to which the fund was exposed to ABS. Indeed, when, following the meeting, Yanni Partners advised its clients to remain invested in SSgA's Commodities Fund (which was invested in LDBF), many of those clients saw the value of their LDBF investments plummet with the onset of the subprime crisis in 2007. We find that one second-tier penalty of $65,000 is warranted to deter him and others in similar positions from future violations.

We find that Flannery also committed at least one violation of the securities laws based on his course of conduct relating to the August 2 and August 14 letters. Flannery's violation, like Hopkins's, created a significant risk of harm to investors who remained in LDBF during the

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202 *See* 15 U.S.C. § 80a-9(b), (d); *id.* § 80b-3(f),(i).

203 *See id.* § 80a-9(d)(1); *id.* § 80b-3(i)(1)(A).

204 *See id.* § 80a-9(d)(3); *id.* § 80b-3(i)(3).

205 *See id.* § 80a-9(d)(2); *id.* § 80b-3(i)(2).

206 *See id.* § 80a-9(d)(2); *id.* § 80b-3(i)(2); 17 C.F.R. § 201.1003 & Pt. 201, Subpt. E, Tbl. III.

subprime crisis while better informed SSgA clients were fleeing the fund. Indeed, just as Flannery himself warned during the Investment Committee meeting on July 25, 2007, the investors who remained in the fund through late July and August 2007 were "stuck with a lower quality portfolio" after proceeds from the sale of LDBF's highest-rated assets were used for redemptions. Flannery's conduct, we find, warrants one first-tier penalty of $6,500, which will help to deter Flannery and others in similar positions from engaging in future violations.

An appropriate order will issue.[207]

By the Commission (Chair WHITE and Commissioners AGUILAR and STEIN); Commissioners GALLAGHER and PIWOWAR, dissenting.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

207 We have considered all of the parties' contentions. We have rejected or sustained them to the extent that they are inconsistent or in accord with the views expressed in this opinion.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9689 / December 15, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73840 / December 15, 2014

INVESTMENT ADVISERS ACT OF 1940
Release No. 3981 / December 15, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31374 / December 15, 2014

Admin. Proc. File No. 3-14081

In the Matter of

JOHN P. FLANNERY and
JAMES D. HOPKINS

ORDER IMPOSING REMEDIAL SANCTIONS

On the basis of the Commission's opinion issued this day, it is

ORDERED that John P. Flannery be suspended for one year from association with any investment adviser or investment company; and it is further

ORDERED that James D. Hopkins be suspended for one year from association with any investment adviser or investment company; and it is further

ORDERED that John P. Flannery cease and desist from committing or causing any violations or future violations of Section 17(a)(3) of the Securities Act of 1933; and it is further

ORDERED that James D. Hopkins cease and desist from committing or causing any violations or future violations of Section 17(a)(1) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Exchange Act Rule 10b-5 thereunder; and it is further

ORDERED that John P. Flannery pay a civil money penalty of $6,500; and it is further

ORDERED that James D. Hopkins pay a civil money penalty of $65,000.

Payment of the civil money penalty shall be (i) made by United States postal money order, certified check, bank cashier's check, or bank money order; (ii) made payable to the Securities and Exchange Commission; (iii) mailed to Enterprises Services Center, Accounts Receivable Branch, HQ Bldg., Room 181, 6500 South MacArthur Blvd., Oklahoma City, OK 73169; and (iv) submitted under cover letter that identifies the respondent and the file number of this proceeding.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73844 / December 16, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31375 / December 16, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16316

In the Matter of PAUL J. POLLACK and MONTGOMERY STREET RESEARCH, LLC, Respondents.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, AND NOTICE OF HEARING

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Paul J. Pollack ("Pollack") and Montgomery Street Research, LLC ("Montgomery Street") (collectively, "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. SUMMARY

1. Pollack, through an entity he solely owns and controls, Montgomery Street, served as an outside consultant to Issuer A, a company quoted on OTC Link that is engaged in the acquisition and development of oil and natural gas reserves. In exchange for services provided to Issuer A, Pollack received various compensation, including more than 600,000 shares of Issuer A common stock.

2. From approximately July 2011 through June 2012, Pollack created a false appearance of market activity in Issuer A's stock by engaging in approximately 100 wash trades through his control of eight brokerage accounts at five broker-dealers. In addition, Respondents acted as unregistered brokers by raising funds on behalf of Issuer A in two private placements. Specifically, in Issuer A's common stock offering and preferred stock offering, Respondents raised over $2.5 million from 11 investors. Among other things, Respondents identified and solicited potential investors, provided financial information regarding the issuer, fielded investor inquiries, and with respect to the preferred stock offering, they received transaction-based compensation. Throughout their fund-raising for the issuer, Respondents were not registered as brokers nor associated with a registered broker-dealer. By virtue of this conduct, Montgomery Street violated Section 15(a) of the Exchange Act, and Pollack violated Sections 9(a)(1), 10(b) and 15(a) of the Exchange Act and Rules 10b-5(a) and 10b-5(c) thereunder.

B. RESPONDENTS

3. **Paul J. Pollack ("Pollack")**, age 54, resides in Phoenix, Arizona. From approximately 1989 to 2001, Pollack was a registered representative associated with broker-dealers registered with the Commission. However, during the relevant period, Pollack was not registered with the Commission as a broker-dealer or associated with a registered broker-dealer. Pollack participated in an offering of Issuer A stock, which is a penny stock. Issuer A issued 45,000 shares to Pollack.

4. **Montgomery Street Research, LLC ("Montgomery Street")** is a Nevada limited liability company with its principal place of business in Phoenix, Arizona, that purports to provide equity research and consulting services. Pollack formed Montgomery Street in 2005, and he has been its sole owner and managing member since its inception. Montgomery Street is not, and has never been, registered with the Commission in any capacity. Montgomery Street participated in an offering of Issuer A stock, which is a penny stock.

C. OTHER RELEVANT ENTITIES

5. **Bhog Partners, LLC ("Bhog Partners")** is a Wyoming limited liability company that has been solely owned and controlled by Pollack since its formation in March 2012. Bhog Partners has no operations, but rather was created to allow for the deposit and trading of micro-cap stock in brokerage accounts controlled exclusively by Pollack and under Bhog Partners' name. Issuer A issued 200,000 shares to Bhog Partners. Bhog Partners has never been registered with the Commission in any capacity.

6. **Toro Holdings, LLC ("Toro Holdings")** is a Nevada limited liability company that has been solely owned and controlled by Pollack since its formation in 2006. Toro Holdings has no operations, but rather was created to allow for the deposit and trading of micro-cap stock in brokerage accounts controlled exclusively by Pollack and under Toro Holdings name. Issuer A issued 200,000 shares to Toro Holdings. Toro Holdings has never been registered with the Commission in any capacity.

7. **Giddy-Up Partners, LLC ("Giddy-Up Partners")** is a Nevada limited liability company that has been solely owned and controlled by Pollack since its formation in 2008. Giddy-Up Partners has no operations, but rather was created to allow for the deposit and trading of micro-cap stock in brokerage accounts controlled exclusively by Pollack and under Giddy-Up Partners name. Issuer A issued 220,000 shares to Giddy-Up Partners. Giddy-Up Partners has never been registered with the Commission in any capacity.

D. POLLACK AND MONTGOMERY STREET ACTED AS UNREGISTERED BROKERS

8. In March 2010, Issuer A entered into a letter agreement with Montgomery Street (the "Letter Agreement") for a three-year term beginning on March 2, 2010. Pursuant to the Letter Agreement, Montgomery Street was to provide "general advice to the Company, its growth strategies, and position within the public capital markets." In exchange for these services, Montgomery Street was to receive "$500,000 to be paid in the form of 80,000,000 shares of [Issuer A] Common Stock." On April 18, 2011, Issuer A declared a 1:100 reverse split of Issuer A stock, changing the number of shares due Montgomery Street under the Letter Agreement from 80,000,000 to 800,000.

9. Notwithstanding the vague characterization of the services contained in the Letter Agreement, Issuer A in fact hired Respondents to raise money and to make introductions to potential investors.

10. Issuer A conducted two private placements of its securities during the three-year term of the Letter Agreement. The first offering was a sale of common stock to raise funds to cover expenses associated with Issuer A's pursuit of listing on a national exchange. The second offering was a sale of preferred stock and was designed to raise funds to purchase certain assets.

11. From approximately November 2010 through April 2011, Respondents participated in effecting transactions in Issuer A's common stock through their involvement at key points in the chain of distribution. Pollack, acting on behalf of Montgomery Street, among other things:

a. Identified prospective investors;

b. Solicited prospective investors in phone calls, emails, and meetings;

c. Provided prospective investors with common stock offering materials, including subscription agreements; and

d. Directed interested investors how to complete Issuer A's common stock subscription agreement and provide funds to Issuer A.

12. In addition, at Pollack's direction, an independent contractor serving as an analyst at Montgomery Street ("Analyst A") described Issuer A's business plan to potential investors; prepared investment highlights on behalf of Issuer A; distributed models regarding Issuer A's

financial prospects to potential investors; fielded investor inquiries; and provided wiring instructions to interested investors.

13. Following solicitation by Respondents, nine investors purchased a total of $445,000 of Issuer A's common stock, constituting 74% of the $600,000 total amount raised in the offering.

14. From approximately August 2011 through November 2011, Respondents participated in effecting transactions in Issuer A's preferred stock through their involvement at key points in the chain of distribution. Pollack, acting on behalf of Montgomery Street, among other things:

a. Assisted in formulating key aspects of the offering, including the convertible stock yield, the aggregate amount sought by Issuer A in the offering, and the structure as a preferred stock offering;

b. Identified prospective investors;

c. Solicited prospective investors in phone calls, emails, and meetings;

d. Explained and fielded questions regarding Issuer A's operations, financial condition, and business prospects;

e. Provided prospective investors with preferred stock offering materials, including subscription agreements; and

f. Directed interested investors how to complete Issuer A's preferred stock subscription agreement and provide funds to Issuer A.

15. In addition, at Pollack's direction, Analyst A continued to maintain and distribute models regarding Issuer A's financial prospects to prospective investors.

16. Following solicitation by Respondents, three investors purchased a total of $2,100,000 of Issuer A's preferred stock, constituting 40% of the $5,200,000 total amount raised in the offering.

17. In connection with the preferred stock offering, Pollack and the CEO of Issuer A reached an oral agreement whereby Issuer A was to pay Respondents 5% of the value of Issuer A's preferred stock purchased by Pollack and Montgomery Street investors. Pursuant to their oral agreement, Respondents later received approximately $105,000 in transaction-based compensation from Issuer A.

18. Pollack and entities controlled by Pollack received 665,000 of the 800,000 shares of Issuer A common stock due pursuant to the Letter Agreement:

a. Toro Holdings was issued 100,000 shares of Issuer A common stock on or about April 28, 2011. The value of those shares on that date was $760,000;

b. Toro Holdings was issued an additional 100,000 shares of Issuer A common stock on or about June 16, 2011. The value of those shares on that date was $415,000;

c. Giddy-Up Partners was issued 120,000 shares of Issuer A common stock on or about June 16, 2011. The value of those shares on that date was $498,000;

d. Giddy-Up Partners was issued an additional 100,000 shares of Issuer A common stock on or about August 1, 2011. The value of those shares on that date was $430,000;

e. Bhog Partners was issued 200,000 shares of Issuer A common stock on or about August 23, 2011. The value of those shares on that date was $660,000; and

f. Pollack was issued 45,000 shares of Issuer A common stock on or about June 4, 2013. The value of those shares on that date was $8,100.

19. The total value of the shares issued to Pollack and his various entities pursuant to the Letter Agreement was $2,771,100.

E. POLLACK MANIPULATED THE VOLUME OF ISSUER A STOCK

20. From approximately December 2010 through October 2012, Pollack had exclusive trading authority over at least ten online brokerage accounts at five broker-dealers. Seven of these accounts were in the name of three entities that Pollack solely-owned and controlled, including three accounts in the name of Montgomery Street; three accounts in the name of Toro Holdings; and one account in the name of Bhog Partners.

21. From December 31, 2010 through October 8, 2012, in open market transactions, the ten Pollack-controlled accounts bought a total of 5,347,557 Issuer A shares and sold a total of 5,661,051 shares for net proceeds of $808,478.73.

22. During that period, Pollack conducted 4,341 transactions in Issuer A stock on 300 trading days. On 140 of the 300 trading days, the Pollack-controlled accounts were responsible for over 50% of the reported Issuer A trading volume. On 19 of the 300 trading days, the Pollack-controlled accounts were responsible for over 90% of reported Issuer A trading volume.

23. From at least July 2011 through June 2012, eight Pollack-controlled accounts manipulated the market for Issuer A stock by engaging in the practice of wash trading. Wash trading is the purchase and sale of a security, either simultaneously or within a short period of time, that involves no change in the beneficial ownership of the security, as a means of creating artificial market activity. Specifically, Pollack placed buy (or sell) orders for Issuer A stock in one account he controlled, and then simultaneously or within a short period of time entered sell (or buy) orders for Issuer A stock at the exact same price in the exact same or virtually identical quantities in another account he controlled. These paired transactions had no economic impact on Pollack's

position in Issuer A. By repeatedly making wash trades in the stock of Issuer A, Pollack, intended to and did, create a false or misleading appearance of active trading in the stock of Issuer A.

24. Pollack's creation of a false or misleading appearance of active trading in the stock of Issuer A, an otherwise thinly traded stock, also applied upward pressure on the price of Issuer A stock.

25. Some of Pollack's wash trades in Issuer A during July 2011 illustrate his manipulative pattern:

a. On July 18, 2011 at 9:38:48, Pollack placed an order through his Toro Holdings Account #1 to *buy* 1500 shares of Issuer A at $4.20 per share. Just 18 seconds later, at 9:39:06, Pollack placed an order through his Toro Holdings Account #2 to *sell* 1500 shares of Issuer A at $4.20 per share;

b. Similarly, on July 27, 2011, at 13:47:03, Pollack placed an order through his Montgomery Street Account #1 to *buy* 500 shares of Issuer A at $4.78 per share. Just 15 seconds later, at 13:47:18, Pollack placed an order through his Toro Holdings Account #2 to *sell* 500 shares of Issuer A at $4.78 per share.

26. Pollack's wash trades on August 15, 2011 further illustrate his manipulative pattern. On that day, Pollack conducted eight wash trades in three accounts he controlled, and Pollack's trading was responsible for 99.06% of Issuer A's total reported volume. Notably, seven of his eight wash trades were separated by thirty seconds or less.

Pollack Wash Trades on August 15, 2011

Account	Ticker	Order Date	Order Time	Trade Time	Sell/Buy	Price	Quantity
Toro Holdings Account 1	Issuer A	08/15/2011	10:22:38	10:25:02	Buy	$3.25	200
Toro Holdings Account 1	Issuer A	08/15/2011	10:24:06	10:25:02	Buy	$3.25	1000
Montgomery St Account 1	Issuer A	08/15/2011	10:24:49	10:25:02	Sell	$3.25	1200
Toro Holdings Account 1	Issuer A	08/15/2011	10:28:05	10:28:15	Buy	$3.30	500
Montgomery St Account 1	Issuer A	08/15/2011	10:28:11	10:28:15	Sell	$3.30	500
Toro Holdings Account 1	Issuer A	08/15/2011	13:45:30	13:46:04	Buy	$3.20	1999
Montgomery St Account 1	Issuer A	08/15/2011	13:45:52	13:46:04	Sell	$3.20	2000
Montgomery St Account 2	Issuer A	08/15/2011	13:50:12	13:50:55	Buy	$3.25	1500
Montgomery St Account 1	Issuer A	08/15/2011	13:50:27	13:50:55	Sell	$3.25	1500
Montgomery St Account 1	Issuer A	08/15/2011	13:52:35	13:52:57	Buy	$3.30	500
Montgomery St Account 1	Issuer A	08/15/2011	13:52:45	13:52:57	Sell	$3.30	500
Toro Holdings Account 1	Issuer A	08/15/2011	14:44:27	14:44:38	Buy	$3.49	501
Montgomery St Account 1	Issuer A	08/15/2011	14:44:34	14:44:38	Sell	$3.49	501
Montgomery St Account 1	Issuer A	08/15/2011	14:44:34	14:45:50	Sell	$3.49	499

Toro Holdings Account 1	Issuer A	08/15/2011	14:45:28	14:45:50	Buy	$3.49	500
Montgomery St Account 2	Issuer A	08/15/2011	15:10:17	15:11:05	Buy	$3.25	2000
Montgomery St Account 1	Issuer A	08/15/2011	15:10:47	15:11:05	Sell	$3.25	2000

27. Pollack engaged in this manipulative strategy repeatedly. From approximately July 2011 through June 2012, Pollack conducted approximately 100 wash trades in Issuer A stock where the buy/sell orders came within 90 seconds of one another, and where the price and quantity were identical or virtually identical. In 85 of those instances, the buy/sell orders came within 60 seconds of one another. In many cases, Pollack's wash trade orders were placed only seconds apart.

28. None of the 100 wash trades by the various Pollack-controlled accounts involved a change in the beneficial ownership of the security. In 31 of the 100 wash trades, the *same* Pollack-controlled entity placed virtually identical buy/sell orders, using different brokerage accounts. In the other 69 wash trades, Pollack placed virtually identical buy/sell orders through some combination of personal accounts and accounts of entities that he controlled. In numerous instances, Pollack bought and sold the stock of Issuer A in multiple accounts on the same day.

29. During the period in which Pollack's wash trades created a false or misleading appearance of active trading in the stock of Issuer A (July 18, 2011 through June 19, 2012), he obtained net trading proceeds in the stock of approximately $369,686.23.

F. VIOLATIONS

30. As a result of the conduct described above, Pollack willfully violated Section 9(a)(1) of the Exchange Act, which prohibits any person from engaging in wash sales "[f]or the purpose of creating a false or misleading appearance of active trading in any security other than a government security, or a false or misleading appearance with respect to the market for any such security. . ."

31. As a result of the conduct described above, Pollack willfully violated Section 10(b) of the Exchange Act and Rules 10b-5(a) and 10b-5(c) thereunder, which prohibit fraudulent conduct in connection with the purchase or sale of securities.

32. As a result of the conduct described above, Pollack and Montgomery Street willfully violated Section 15(a)(1) of the Exchange Act, which makes it unlawful for any broker or dealer to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security unless such broker or dealer is registered with the Commission pursuant to Section 15(b) of the Exchange Act (or, if a natural person, associated with a registered broker-dealer other than a natural person).

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9 of the Investment Company Act; and

D. Whether, pursuant to Section 21C of the Exchange Act and Section 9 of the Investment Company Act, Respondents should be ordered to cease and desist from committing or causing violations of and future violations of Sections 9(a)(1), 10(b), and 15(a) of the Exchange Act and Rules 10b-5(a) and 10b-5(c) thereunder, whether Respondents should be ordered to pay a civil penalty pursuant to Section 21B(a) of the Exchange Act and Section 9(d) of the Investment Company Act, and whether Respondents should be ordered to pay disgorgement pursuant to Sections 21B(e) and 21C(e) of the Exchange Act and Section 9 of the Investment Company Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents as provided for in the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9690 / December 16, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73851 / December 16, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31378 / December 16, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16318

In the Matter of **MICHAEL W. CROW, ALEXANDRE S. CLUG, AURUM MINING, LLC, PANAM TERRA, INC., and THE CORSAIR GROUP, INC.,** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, AND NOTICE OF HEARING**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act"), and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act"), against Michael W. Crow ("Crow"), Alexandre S. Clug ("Clug"), Aurum Mining, LLC ("Aurum"), PanAm Terra, Inc. ("PanAm"), and The Corsair Group, Inc. ("Corsair") (collectively "Respondents").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENTS

1. **Crow**, age 55, was a resident of Miami, Florida, and Lima, Peru during the relevant period. Until early 2014, Crow was a principal and manager of Aurum, a privately-held company that purported to own and operate gold mines in Brazil and Peru. Together with Clug, Crow also owned and controlled Corsair, an entity that purported to provide consulting services to businesses. Crow also participated in the management of PanAm, a public company whose stock was registered with the Commission, though he has been barred since 1998 from serving or acting as an officer or director of a public company. In 2008, Crow was also barred from associating with any broker, dealer or investment adviser. In 2010, Crow filed for personal bankruptcy.

2. **Clug**, age 46, was a resident of Miami, Florida and Lima, Peru during the relevant period. Clug is a principal and manager of Aurum and, together with Crow, owned and controlled Corsair. Clug served as PanAm's CEO and Chairman of the Board from at least April 2011 until July 2012, when he resigned as CEO but remained as Chairman. Clug did not hold any securities industry licenses during the relevant period.

3. **Aurum** is a Nevada limited liability company established in April 2011, with its principal place of business in Miami, Florida. Crow and Clug each owned 50% of Aurum's voting shares during the relevant period. Crow and Clug served as managers of Aurum. Aurum was not registered with the Commission in any capacity during the relevant period.

4. **PanAm** is a Nevada corporation with its principal place of business in Miami, Florida. Formerly known as Duncan Technology Group, PanAm evolved from an entity which existed since 2001. In April 2011, it was renamed "PanAm Terra, Inc.," and registered its common stock with the Commission pursuant to Section 12(g) of the Exchange Act. PanAm deregistered its common stock in May 2013.

5. **Corsair** is a Florida corporation incorporated in April 2011 with its principal place of business in Miami, Florida. Corsair was owned and controlled by Crow and Clug. Corsair was not registered with the Commission in any capacity during the relevant period.

B. OTHER RELEVANT INDIVIDUALS AND ENTITIES

6. **Aurum Mining Peru, S.A.** ("Aurum Peru") is a Peruvian subsidiary of Aurum based in Lima, Peru. Crow and Clug controlled the finances and operations of Aurum Peru during the relevant period. Aurum Peru received more than $2 million dollars in proceeds from Aurum investors.

7. **Arthom Participacoes, Ltda.** ("Arthom") was a Brazilian entity owned or controlled by two individuals located in Brazil during the relevant period.

8. **Batalha Mineradora, Ltda.** ("Batalha JV") was a joint venture operation between Aurum and Arthom for the acquisition and operation of a piece of mineral property in Brazil called Batalha.

9. **ABS Manager, LLC** ("ABS") is a limited liability company formed in Arizona in 2009, with its principal place of business in La Jolla, California.

C. FACTS

Crow is Enjoined and Barred for his Previous Violative Conduct

10. On September 24, 1996, the Commission filed an action alleging, among other things, that Crow, as President and Chairman of the Board of Wilshire Technologies, Inc. ("Wilshire"), a public company, caused Wilshire to materially overstate its earnings through various fraudulent schemes and also that Crow engaged in insider trading. SEC v. Crow, 96-cv-1661 (S.D. Cal.).

11. On April 16, 1998, the District Court for the Southern District of California entered a judgment that: (1) permanently enjoined Crow from violating Section 17(a) of the Securities Act and Sections 10(b), 13(a), 13(b)(2)(A) and 13(b)(2)(B) of the Exchange Act and Rules 10b-5, 12b-20, 13a-13, 13b2-1 and 13b2-2 thereunder; (2) ordered Crow to disgorge $1,248,444 plus prejudgment interest of $225,773, with the judgment satisfied by the resolution of a related securities class action lawsuit; and (3) stated that Crow "is permanently barred from acting as an officer or director of any issuer[.]" Crow consented to the entry of the judgment without admitting or denying the allegations.

12. The Commission then issued an order, with Crow's consent, denying Crow the privilege of appearing or practicing before the Commission as an accountant. Michael W. Crow, Exchange Act Rel. No. 39902 (Apr. 22, 1998).

13. On May 15, 2007, the Commission filed a second action against Crow, alleging, among other things, that Crow acted as an unregistered principal of Duncan Capital LLC, a registered broker-dealer, in violation of Section 15(a) of the Exchange Act. SEC v. Crow, 07-cv-3814 (S.D.N.Y.).

14. On November 5, 2008, after a bench trial in the District Court for the Southern District of New York, the district judge issued findings of fact, including that:

> There is no assurance that Crow can be trusted in the future to comply with securities laws. Crow has not acknowledged any wrongdoing. He had been enjoined once already and has acted in breach of the terms of that consent agreement with the SEC. In his actions at the Duncans, he has demonstrated a willingness to disregard the advice of counsel and he took steps to cover up what he

> was actually doing. His conduct was egregious and he acted with scienter. In addition, he perjured himself in this court.

15. On November 13, 2008, the District Court issued a final judgment that: (1) enjoined Crow from aiding and abetting violations of Sections 15(a), 15(b)(1), 15(b)(7) of the Exchange Act and Rules 15b3-1 and 15b7-1 thereunder; (2) ordered Crow to pay $6,996,103.87 in disgorgement and prejudgment interest, jointly and severally with others; and (3) ordered Crow to pay a civil monetary penalty of $250,000.

16. Based on the final judgment, the Commission instituted an administrative proceeding against Crow. Following a motion for summary disposition filed by the Commission's Division of Enforcement, the Administrative Law Judge issued an Initial Decision as to Crow, dated April 22, 2009, which stated that:

> Crow's actions were egregious on their face, a fact affirmed by the findings [of the district judge] following a lengthy bench trial, and the almost five-and-a-half million dollars in disgorgement she ordered, exclusive of prejudgment interest. Based on evidence from Crow and others, [the district judge] found that Crow acted with scienter and that he perjured himself in court. Crow's actions were not isolated, but continued for over a year, and followed separate proceedings in 1998 where a federal district court enjoined him from future antifraud violations and barred him from serving as an officer or director of a public company, and the Commission, in an administrative proceeding, denied him the privilege of appearing before the Commission as an accountant. Crow's conduct demonstrates that he is an unreformed recidivist who poses a serious future threat to the investing public.

17. Based on those findings, Crow was barred from association with any broker, dealer or investment adviser. Michael W. Crow, Initial Decision Rel. No. 376 (Apr. 22, 2009). In May 2009, the Initial Decision became final. Michael W. Crow, Exchange Act Rel. 59982 (May 27, 2009).

18. On January 22, 2010, Crow filed a Voluntary Petition in the U.S. Bankruptcy Court for the Southern District of California under Chapter 7 of the Bankruptcy Code. Crow's petition stated that he had approximately $28,000 in assets and $11.5 million in liabilities, including judgments, liens, alimony, and child support. See In re Michael Wayne Crow, No. 10-000978-LT7 (Bankr. S.D. Cal. Jan. 22, 2010).

19. On January 20, 2012, the court-appointed bankruptcy trustee filed an action against Crow, alleging that Crow made fraudulent transfers, preferences and post-petition transfers. Trustee v. M.W. Crow Family, L.P., et al., 10-00978-LT7 (Bankr. S.D. Ca. Jan. 20, 2012).

Crow Devises New Money-Making Schemes

20. In early 2010, after filing for bankruptcy, Crow began planning new money-making schemes.

21. Around that time, Crow and Clug used a shell entity, Duncan Technology Group, to launch PanAm, with the aim of getting it listed on an exchange as a publicly-traded company. In early 2011, Crow and Clug traveled to Brazil and Argentina. Upon their return, they caused PanAm to file a Form 10 with the Commission, registering its common stock under Section 12(g) of the Exchange Act.

22. In April 2011, Crow and Clug formed Corsair and Aurum. Crow and Clug used Aurum, PanAm and Corsair to raise funds from investors in the U.S., purportedly to launch farmland and gold mining operations in South America. However, neither Crow nor Clug had any expertise or experience in farmland management or the mining industry.

23. When they formed Aurum, Crow and Clug allocated to themselves 650,000 each in controlling Class B membership units in Aurum through their respective personal shell entities. Crow and Clug did not invest any of their own money in Aurum.

24. Corsair entered into consulting or advisory agreements with Aurum and PanAm. Through this structure, Crow and Clug collected fees from proceeds obtained from investors in Aurum and PanAm, even though Aurum and PanAm never generated any revenue. Between February 2012 and November 2013, Crow and Clug received at least $600,000 in Corsair fees from Aurum and PanAm.

Respondents Fraudulently Offer and Sell Aurum Securities

The Aurum Convertible Notes and Term Sheet

25. Between May and June 2011, Aurum, through a term sheet dated May 10, 2011 ("Term Sheet"), raised $250,000 from nine investors in Florida and Connecticut through the offer and sale of "Senior Secured Convertible Notes." The notes were secured by Aurum's minimal assets and offered investors 8% return with a nine month maturity date. The notes also offered investors an option to convert their notes into equity at a 50% discount or $2.50 per share at the earlier of the "Close" or maturity. The notes defined the "Close" as "the financing and closing of the acquisition on the land rights and mining rights for the Gold project known as Batalha."

26. The Term Sheet also stated that the note proceeds would be used to "complete due diligence including final report from engineers, legal, travel and costs related to the land purchase and startup operations." Instead, a majority of the funds raised went to personally benefit Crow and Clug.

The August 2011 PPM

27. In August 2011, Crow, Clug and Aurum's Chief Financial Officer (the "CFO") started soliciting investors to invest in non-voting Class A equity membership units in Aurum at $5 per unit. They provided investors, including some of the convertible note investors, with a Private Placement Memorandum dated August 1, 2011 (the "August 2011 PPM"). The August 2011 PPM provided a detailed description of Crow's professional background, including his designation as a CPA and his work experience prior to becoming President and Chairman of Wilshire. However, it omitted Crow's role and activities at Wilshire, his history of securities law violations, his pending bankruptcy, and the fact that his CPA license had expired.

28. The August 2011 PPM stated that closing would not occur and investor funds would be escrowed until at least $1 million had been raised in the equity offering and "certain closing conditions" relating to the Batalha gold project had been satisfied.

29. The "closing conditions" in the PPM required, first, that Aurum and Arthom enter into a joint venture agreement on substantially the same terms as provided in the August 2011 PPM. Second, Aurum was to receive a geological report from a qualified and licensed geologist, attesting to his opinion regarding the average and/or total gold content of the Batalha tailings. Third, Aurum was to receive an opinion of Brazilian legal counsel stating that: (a) the Batalha JV had been duly formed under Brazilian law and Aurum owned a minimum of 49% in the Batalha JV subject to Aurum's required full funding of $2.5 million; (b) the Batalha JV owned or had irrevocable rights to the land and mining rights to Batalha; and (c) the Batalha JV had received the licenses from the Brazilian government required to implement the Batalha JV's business plan with respect to Batalha.

30. Aurum and Arthom entered into a joint venture agreement dated December 12, 2011 (the "Batalha JV Agreement"), which purported to modify and replace a prior agreement. The Batalha JV Agreement provided for a 50-50 ownership between Aurum and Arthom. It required Arthom to transfer its claimed contractual right in the Batalha property to the Batalha JV. It also required Aurum to provide funding, in the form of loans to the Batalha JV, starting with an initial funding of $750,000. The $750,000 was to be used primarily to purchase equipment for the Batalha project, among other things.

31. By December 31, 2011, Crow and Clug had virtually depleted the $250,000 proceeds from the convertible notes, which were due to mature in less than two months. By then, Aurum had raised only $115,000 from investors in the equity offering, which had not been escrowed, contrary to what Aurum represented to investors in the August 2011 PPM. Rather, Aurum kept the funds in its savings account, to which Crow and Clug had unfettered access. Crow had also depleted his personal account. Faced with a potential default on the convertible notes and in an apparent attempt to replenish Crow's personal account, Crow and Clug lied to investors about Batalha as detailed below.

The December 2011 PPM and PPM Update Letter

32. In January 2012, Aurum sent another PPM dated December 31, 2011 (the "December 2011 PPM") and an "update" letter ("PPM Update Letter") to investors, mostly convertible note holders. The PPM Update Letter included an acknowledgement of receipt and acceptance of the December 2011 PPM by the investors. The December 2011 PPM represented that no subscriptions would be accepted until Aurum had raised at least $250,000 in equity and the PPM closing conditions had been satisfied.

33. In late January 2012, after Aurum disseminated the December 2011 PPM and the PPM Update Letter to investors, Crow and Clug accessed the purportedly escrowed equity investor proceeds to pay themselves fees.

34. Both the December 2011 PPM and the PPM Update Letter contained material misrepresentations and omissions designed to entice investors to retain or increase their investments in Aurum.

35. Specifically, the December 2011 PPM and the PPM Update Letter misled investors about Aurum's ownership interest in the Batalha property. The December 2011 PPM represented that Arthom had purchased and owned or controlled the land and rights to the Batalha property. It further represented that Arthom had contributed the property to the Batalha JV and that Batalha was "ready to initiate processing." The PPM Update Letter stated:

> As you know, we started 2011 focused on acquiring an interest in Batalha, a 3,742 hectare property in northern Brazil with our partners there. We additionally wanted to complete the initial tests and geology to ascertain the reserves. We have completed all of this successfully.

36. The PPM Update Letter further stated that Aurum had "[c]losed on acquiring the 50% interest in Batalha, our Brazil gold project" and that Aurum had "satisfied the conditions of closing on the Aurum original PPM," referring to the Batalha closing conditions of the August 2011 PPM.

37. These representations were false because Aurum never acquired an interest in the Batalha property nor did the Batalha JV obtain the required mining licenses.

38. The August 2011 PPM also required that Aurum receive an opinion from Brazilian legal counsel that the Batalha JV owned or had irrevocable rights to the Batalha land and mining rights and that it had obtained the required licenses from the Brazilian authorities. This never happened. In fact, on March 8, 2012, Crow and Clug received an email from Brazilian counsel, which stated:

> We still have no proof that Batalha has mining rights and land nor [sic] that it has the right to acquire such mining rights and land. We dont [sic] recommend any further investment at this point.

39. Even after receiving this email from Brazilian counsel, Crow and Clug failed to correct the material misrepresentations and omissions about Batalha in the December 2011 PPM. Instead, they continued to falsely represent to investors that Aurum owned property in Brazil. Aurum also falsely represented that it had actually purchased land in Brazil and misled investors about Batalha's status in Aurum's 2012 quarterly update reports. Aurum never satisfied the Batalha closing conditions. Nevertheless, Aurum continued to use the December 2011 PPM and quarterly reports to solicit new investors.

40. The December 2011 PPM and PPM Update Letter also contained material misrepresentations and omissions concerning, among other things: (a) the use of investor proceeds; (b) test results and financial projections relating to the Batalha property; and (c) the acquisition of other gold properties in Peru.

41. The Aurum operating agreement represented that Aurum would provide investors with annual audited and unaudited financial statements. Aurum failed to do so.

42. Both the August 2011 PPM and the December 2011 PPM stated that Crow and Clug, through entities they controlled, had received "Class B Units in consideration of [their] efforts in organizing Aurum Mining, advancing all the costs and time, formulating its business plan, and contributing the Letter of Intent and the rights attached to Aurum Mining LLC." The PPMs also stated that Corsair was entitled to receive "incentive compensation" from gross revenues, but only after certain hurdles were reached. The PPMs stated that, "[t]he terms on which the Managers and [Corsair] will be compensated ... were determined by the Managers [and no] disinterested party has confirmed the fairness of those terms ... ."

43. Crow and Clug used investor proceeds to: (i) pay themselves each a salary of $12,500 per month; (ii) collect at least $2,000 each a month for apartments in an upscale part of Lima, Peru; (iii) draw $1,500 each a month in cash for pocket money; and (iv) cover their living, travel and other expenses.

44. The December 2011 PPM also provided a detailed description of Crow's professional background but it omitted Crow's securities industry bars and his pending bankruptcy. Instead, it referred investors to a "data room" for details on "any past litigation" involving Aurum's managers.

45. Between mid-January and February 2012, Aurum sent the PPM Update Letter to all the note investors and urged them to convert their notes into equity with misleading information about Aurum's business prospects in Brazil and Peru. Aurum also sent the PPM Update Letter to existing equity investors inducing them to invest more money in Aurum.

46. From August 2011 to September 2012, Aurum raised approximately $2.2 million from at least 20 investors in Florida, Connecticut and California.

The Aurum Quarterly Updates to Investors

47. In mid-2012, Aurum started sending quarterly reports to "update" existing and prospective Aurum investors which were replete with material misrepresentations and omissions about Aurum's business prospects. Through these quarterly reports, Aurum misled investors about its ownership interests in various mineral properties in Brazil and Peru, the test results obtained from those properties, and the timing of production and cash flow associated with those properties. The quarterly updates were written or reviewed by Crow and Clug.

48. For instance, the 2012 first quarter report, dated May 2012, represented that Aurum had acquired "two excellent mining concessions" in Peru, referring to the Cobre Sur and Molle Huacan concessions. To the contrary, Aurum had acquired only an option to purchase the concessions subject to meeting substantial payment obligations to the owners.

49. In addition, by April 16, 2012, Crow and Clug already knew that one of the sites, Cobre Sur, had negative test results. An American geologist ("Geologist A") tested Cobre Sur and informed Aurum that the gold values were too low to start a mining operation on the property. Notwithstanding, Clug asked whether Geologist A would produce a "project of merit" report for Cobre Sur. Geologist A declined.

50. Geologist A also tested another site, Molle Huacan, during a site visit in April 2012, accompanied by Clug and Aurum's Peruvian geologist. Subsequently, Geologist A issued a report dated October 8, 2012, concluding that "[g]iven the low average grade and small tonnage potential," Molle Huacan was "not ready for production." Nonetheless, Aurum's 2012 third quarter report dated November 5, 2012 falsely represented that the results of Aurum's metallurgy tests on Molle Huacan "have been excellent and indicate high recovery rates at lower cost."

51. The 2012 third quarter report further misled investors about the timing of production and cash flow. It stated that the first day of operational mining in Molle Huacan was projected to occur on November 25, 2012, with processing and cash flow starting by January 2013, and encouraged investors to increase their stake by November 30, 2012, indicating that it would otherwise seek funds from new investors. At least two investors increased their investments after receiving this misleading update.

52. Finally, on July 10, 2013, Clug sent a belated 2013 first quarter report to an investor. Clug wrote in the cover email that "[w]e are working hard here to get into production and processing and thus positive cash flow asap!" and that Aurum was on the verge of finishing its on-site processing plant to start processing and selling gold. The 2013 first quarter report projected that initial production and processing would occur by August 1, 2013 and the overall test results "indicate that our mineral is ideal for a high volume operation and a good fit for the leaching process [sic] plant that we are building." To the contrary, Aurum did not produce any viable amount of gold. The so-called processing plant at Molle Huacan never became operational.

The September 2012 PPM, January 2013 PPM, CIM Offering Circular, and Aurum Business Plan

53. By September 2012, the approximately $2 million raised from the equity offering was substantially depleted. Aurum then prepared a new PPM dated September 15, 2012 ("September 2012 PPM") in a bid to raise $1 million purportedly to build a mineral processing plant and launch mining operations in Peru. Subsequently, Aurum used another PPM dated January 1, 2013 ("January 2013 PPM"), a Confidential Information Memorandum ("CIM"), and an Aurum Business Plan dated January 30, 2013 ("Aurum Business Plan"), in a bid to raise an additional $1 million, also purportedly to build a mineral processing plant and launch mining operations in Peru. The September 2012 PPM, January 2013 PPM, CIM, and Aurum Business Plan also contained material misrepresentations and omissions.

54. The September 2012 PPM stated that Aurum had "uncovered at least 10 significant gold veins and one in which we know there is a lot of copper." It also stated that "[o]ur goal is to be able to initiate mining of the ore from Molle Huacan by the end of Q3 of 2012 and process ourselves by Q2 of 2013." The January 2013 PPM stated that "[o]ur goal is to be able to initiate mining of the ore from Molle Huacan by the end of Q1 of 2013 and process on site." The CIM represented that an independent geological report had concluded that Molle Huacan was "a project of merit with a reasonable plan for drilling to define the ore body."

55. The CIM also stated that Aurum's quick-to-production approach was "focused on generating positive cash flows quickly and the inferred gold resources of the Molle Huacan property means long-term cash flows from its operations." In addition, the CIM confirmed that Aurum had obtained all the required permits and was going into production, falsely stating that "initial production commenced in April 2013" and that Molle Huacan will be in phase 2 production in mid-2013. The CIM projected that within 5 years, Aurum will realize $194,762,960 in net income from Molle Huacan.

56. These are material misrepresentations and omissions because they imply that Molle Huacan already had an ore body of gold and that Aurum was on the verge of producing and processing gold. Contrary to Aurum's claims, a Canadian geologist ("Geologist B") who visited Molle Huacan in February 2013 and had tested the site, found no evidence that Molle Huacan had an ore body of gold. According to Geologist B, an "ore body" is a body of mineralization that is economic to extract, i.e. sufficient to fund its exploration, development, extraction, labor, overhead, and reclamation costs, in addition to providing a reasonable return to investors. Dissatisfied, Clug tried to convince Geologist B to alter or omit some of the negative findings in his draft geological report, including the fact that Geologist B's test results showed lower gold values than those reported by Aurum's local Peruvian geologist. Geologist B declined. Eventually, Geologist B concluded that Molle Huacan did not contain any known mineral resources or reserves.

57. Furthermore, the Aurum Business Plan, which was used as a marketing tool, also contained material misrepresentations and omissions. For instance, it stated that exploration had "confirmed the presence of 7 mineral veins within Molle Huacan" and that "[t]hese rosy class veins have grades between 3 grams and 25 grams of gold." It also estimated that Molle Huacan contained inferred gold mineral resources of a minimum 2,842,000 ounces" on one vein alone. Geologist B found these estimates to inaccurate and exaggerated.

58. The September 2012 PPM and January 2013 PPM referred investors to the data room for "discussion of Mr. Crow's 2008 litigation with the SEC over an investment and ownership of a broker dealer without the requisite securities license and subsequent bankruptcy following the financial meltdown of 2008."

59. From September 2012 to November 2013, Aurum raised approximately $1.5 million from at least 10 investors in Florida, Connecticut, California, and elsewhere.

60. Crow and Clug knew or should have known that the PPMs, PPM Update Letters, the quarterly update reports, and other offering documents disseminated to investors contained material misrepresentations and omissions. Crow and Clug were Aurum's principals, and each was a managing member of Aurum. Each participated in the drafting and approval of the offering documents, and, was directly involved with Aurum's activities in Brazil and Peru.

Respondents Fraudulently Offer and Sell PanAm Securities

61. On April 29, 2011, PanAm filed a Form 10 with the Commission. In its Commission filings and other offering disclosures, PanAm represented to investors that it planned to acquire and control Latin American farmland utilized for permanent crops which can be readily exported to countries that cannot competitively produce sufficient food. PanAm projected that by the end of its third year (2014), it would own 20,000 hectares with a value of $280 million and an enterprise value of approximately $500 million.

62. Prior to PanAm's registration of its common stock with the Commission, Crow played a lead role in directing the affairs of the company. After PanAm became a public company, Crow continued his involvement, operating behind the scenes. Crow was regularly involved in high-level senior management communications concerning PanAm's business affairs and he participated in decision-making activities. For example, Crow negotiated business deals with third parties on behalf of PanAm. Crow also attended conferences and business meetings relating to PanAm and billed his expenses to PanAm. Furthermore, Crow was instrumental in selecting officers and directors of PanAm. Crow performed oversight functions and even threatened to fire PanAm's CFO because of a delay in PanAm's Form 10-K filing with the Commission. Clug and others at PanAm kept Crow informed about PanAm's operations and business plans.

63. Crow obtained two convertible notes from PanAm in March 2011 in exchange for $25,000 in a purported "seed loan" to PanAm in 2010 and $28,000 in purported unreimbursed expenses incurred on behalf of PanAm before it filed its Form 10 with the Commission. Crow had PanAm issue the notes to Pacific Trade Ltd., a shell entity Crow owned and controlled.

64. An advisory agreement between PanAm and Corsair dated July 6, 2012 provided that Corsair would "provide recommendations" to PanAm "in connection with management issues, equity or debt financing as well as other financial matters." Through this advisory agreement, Corsair obtained approximately $40,000 in fees from PanAm, with at least half of the proceeds going to Crow. While PanAm's Commission filings disclosed the Corsair contract, it failed to disclose Crow's role in Corsair.

65. From at least January 2011 to March 2013, PanAm raised $400,000 from about a dozen investors in Florida.

66. The PanAm investors signed subscription agreements which stated that they were relying only on PanAm's Executive Brief ("PanAm Brief") and any other written information furnished by PanAm (*i.e.,* Commission filings). However, the PanAm Brief dated May 2011 falsely represented to investors that PanAm had submitted an application for listing on the OTCBB in April 2011. This was materially misleading to investors because it gave them the false impression that PanAm's shares were poised to become publicly traded with a significant upside.

67. PanAm's Commission filings and offering documents failed to disclose Crow's extensive involvement with PanAm, his pending bankruptcy and the fact that he had been barred as an officer or director of a public company.

68. Furthermore, PanAm represented in its Form D filing in September 2012 that none of the initial $320,000 offering proceeds would be used to pay the officers and directors or promoters of PanAm. This was false because by September 2012 PanAm had used a substantial portion of the proceeds to pay Crow, Clug and another individual acting as PanAm's CEO.

69. Ultimately, PanAm did not acquire a single asset in Latin America. Instead, it used at least $100,000 of the investor proceeds to personally benefit Crow and Clug.

70. Crow and Clug each knew or should have known that PanAm's public filings and offering documents contained material misrepresentations and omissions.

71. Clug, as CEO, signed a certification as to the accuracy of PanAm's Commission filings, pursuant to Exchange Act Rule 13a-14.

Respondents Operated Corsair as an Unregistered Broker-Dealer

72. In January 2012, Corsair entered into a referral agreement with ABS. The agreement required ABS to pay commissions or fees to Corsair based on the principal amount invested by any investor referred by Corsair to ABS. Shortly thereafter, Crow, Clug and Corsair's CFO facilitated a meeting between the ABS portfolio manager and Aurum investors in which the ABS portfolio manager made a marketing pitch to investors. The ABS portfolio manager informed investors that they could invest in purportedly safe GNMA bonds in the ABS portfolio earning 12% return. Crow, Clug and the Corsair CFO also participated in the preparation of a term sheet to enable investors to borrow up to 70% against the value of the investors' ABS accounts to invest in Aurum's equity offerings.

73. Between January 2012 and December 2012, Corsair referred at least six investors to ABS and received at least $10,000 in fees in the form of transaction-based compensation from ABS as a result of investments in ABS made by those referred investors. Crow and Clug shared the fees paid to Corsair.

74. At the time Corsair received the fees from ABS, Corsair was not registered as a broker-dealer with the Commission. In addition, Crow and Clug were not registered as or associated with any registered broker-dealer. In fact, Crow had been barred from, among other things, association with any broker-dealer.

D. VIOLATIONS

75. As a result of the conduct described above, Crow, Clug, Aurum, and PanAm willfully violated Section 17(a) of the Securities Act, Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, which prohibit fraudulent conduct in the offer and sale of securities and in connection with the purchase or sale of securities. Crow and Clug willfully aided and abetted and caused such violations by Aurum and PanAm.

76. As a result of the conduct described above, PanAm willfully violated, and Crow and Clug willfully aided and abetted and caused PanAm's violations of Section 13(a) of the Exchange Act and Rules 12b-20, 13a-1 and 13a-13 thereunder, which require every issuer of a security registered pursuant to Section 12 of the Exchange Act to file complete and accurate annual and quarterly reports with the Commission.

77. As a result of the conduct described above, Clug willfully violated Rule 13a-14 of the Exchange Act, which requires that principal executive and financial officers of an issuer of a security registered pursuant to Section 12 of the Exchange Act certify to the accuracy and completeness of the issuer's annual and quarterly reports filed with the Commission.

78. As a result of the conduct described above, Crow, Clug and Corsair willfully violated Section 15(a)(1) of the Exchange Act, which prohibits any entity from making use of the mails or any means or instrumentality of interstate commerce to effect

transactions in securities without registering as a broker-dealer. Crow and Clug willfully aided and abetted and caused such violation by Corsair.

79. As a result of the conduct described above, Crow willfully violated Section 15(b)(6)(B) of the Exchange Act for acting as or associating with a broker-dealer while under Commission order pursuant to Section 15(b)(6)(A) of the Exchange Act. Clug willfully aided and abetted and caused such violation by Crow.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9 of the Investment Company Act; and

E. Whether, pursuant to Section 8A of the Securities Act, Section 21C of the Exchange Act and Section 9 of the Investment Company Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Section 17(a) of the Securities Act, Sections 10(b), 13(a), 15(a)(1) and 15(b)(6)(B) of the Exchange Act, and Rules 10b-5, 12b-20, 13a-1, 13a-13 and 13a-14 thereunder, whether Respondents should be ordered to pay a civil penalty pursuant to Section 8A(g) of the Securities Act, Section 21B(a) of the Exchange Act and Section 9(d) of the Investment Company Act, and whether Respondents should be ordered to pay disgorgement pursuant to Section 8A(e) of the Securities Act, Sections 21B(e) and 21C(e) of the Exchange Act, and Section 9 of the Investment Company Act .

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondents fail to file the directed answer, or fail to appear at a hearing after being duly notified, the Respondents may be deemed in default and the proceedings may be determined against them upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents as provided for in the Commission's Rules of Practice

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES ACT OF 1933
Release No. 9691 / December 16, 2014

SECURITIES EXCHANGE ACT OF 1934
Release No. 73852 / December 16, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3614 / December 16, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16319

In the Matter of **ANGEL E. LANA, CPA,** **Respondent.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTION 8A OF THE SECURITIES ACT OF 1933, SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Angel E. Lana, CPA ("Respondent" or "Lana") pursuant to Section 8A of the Securities Act of 1933 ("Securities Act"), Sections 4C[1] and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(iii) of the Commission's Rules of Practice.[2]

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1 Section 4C provides, in relevant part, that:

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement ("Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondent consents to the entry of this Order Instituting Public Administrative and Cease-And-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-And-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[3] that:

A. **RESPONDENT**

1. **Lana**, age 56, is a resident of Boca Raton, Florida. He is a certified public accountant ("CPA") licensed to practice in the State of Florida since 1981. Lana has worked as a sole practitioner since 1986, and has performed accounting work for several public companies. Lana also has an affiliation with an accounting firm that represents public companies. From May 2011 to 2014, Lana served as Chief Financial Officer ("CFO") of Aurum Mining, LLC ("Aurum"). Lana was also one of three managers of Aurum and was to receive an aggregate compensation of $288,000 for his services to Aurum during the relevant period, which remains unpaid.

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2 Rule 102(e)(1)(iii) provides, in pertinent part, that:

> The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found...to have willfully violated, or willfully aided and abetted the violation of any provision of the Federal securities laws or the rules and regulations thereunder.

3 The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

B. RELEVANT PERSONS

2. **Alexandre S. Clug ("Clug")**, age 46, was a resident of Miami, Florida and Lima, Peru during the relevant period. Clug is a principal and manager of Aurum. Clug did not hold any securities industry licenses during the relevant period.

3. **Michael W. Crow ("Crow")**, age 55, was a resident of Miami, Florida and Lima, Peru during the relevant period. Crow was a principal and manager of Aurum until early 2014. Crow also owns and controls three Peruvian entities, named Alta Mining, S.A.C., AlterTerra, S.A.C. and Grupo Alta, S.A.C. Since 1998, Crow has been barred from serving or acting as an officer or director of a public company and from appearing or practicing before the Commission as an accountant. SEC v. Crow, 96-cv-1661 (S.D. Cal.); In re Michael W. Crow, Exchange Act Rel. No. 39902 (Apr. 22, 1998). In 2008, Crow was also barred from associating with any broker, dealer or investment adviser. SEC v. Crow, 07-cv-3814 (S.D.N.Y.); In re Michael W. Crow, Initial Dec. Rel. No. 376 (Apr. 22, 2009). In 2010, Crow filed for personal bankruptcy.

4. **Aurum** is a Nevada limited liability company established in April 2011, with its principal place of business in Miami, Florida. Aurum established several subsidiaries in Peru during the relevant period, including Aurum Mining Peru, S.A., Admiral Cove Partners, S.A, Alta Gold, S.A., Carolina Gold, S.A., and Oceano Pacifico Minerales, S.A. Crow and Clug each owned 50% of Aurum's voting shares and controlled Aurum's finances and operations during the relevant period. Crow, Clug and Lana served as the managers of Aurum. Aurum was not registered with the Commission in any capacity during the relevant period.

C. FACTS

5. Lana became involved with Aurum through Clug. In April 2011, Lana accepted Clug's invitation to be the CFO of Aurum. Lana knew that Clug and Crow were the principals of Aurum. Since early 2011, Lana knew that Crow had been barred from serving or acting as an officer or director of a public company and from associating with any broker, dealer or investment adviser. Sometime in 2012, Lana also knew that Crow was in bankruptcy.

6. In April 2011, Clug told Lana that he had identified a gold mining opportunity in Brazil for Aurum. At the time, Lana, Clug and Crow had no experience in mining or geology. Clug also told Lana that Aurum required capital to fund the Brazil venture and asked Lana to help raise funds for Aurum.

7. Lana used a term sheet dated May 10, 2011 to solicit investors, including his tax clients, to invest in Aurum. Between May and June 2011, Aurum raised $250,000 from nine investors in exchange for convertible notes issued by Aurum and secured by Aurum's minimal assets. The notes offered investors 8% return with a nine month maturity date. The notes also

offered investors an option to convert their notes into equity at a 50% discount or $2.50 per share at the earlier of the "Close" or maturity. The notes defined the "Close" as "the financing and closing of the acquisition on the land rights and mining rights for the [Brazilian] Gold project."

8. In August 2011, Lana, Crow and Clug started soliciting investors to invest in non-voting equity membership units in Aurum. They provided investors, including some of the convertible noteholders, with a Private Placement Memorandum dated August 1, 2011 (the "August 2011 PPM"). The August 2011 PPM provided a detailed description of Crow's professional background, including his designation as a CPA and his work experience prior to becoming president and chairman of a public company that led to his officer and director bar. However, the PPM omitted Crow's role and activities at that public company, his history of securities law violations, his pending bankruptcy, and the fact that his CPA license had expired. The August 2011 PPM identified Lana as one of the managers of Aurum, along with Crow and Clug.

9. The August 2011 PPM stated that closing would not occur and investor funds would be escrowed until at least $1 million had been raised in the equity offering and "certain closing conditions" relating to the Brazilian gold project had been satisfied.

10. The "closing conditions" in the August 2011 PPM required that Aurum: (1) enter into a joint venture with its Brazilian partners; (2) receive a geological report from a qualified and licensed geologist stating the gold content in the Brazilian property; and (3) obtain from Brazilian legal counsel an opinion stating that, among other things, the joint venture owned or had irrevocable rights to the land and mining rights, and had received the required licenses from the Brazilian government.

11. Between mid-January and February 2012, Aurum sent another PPM dated December 31, 2011 (the "December 2011 PPM") and a PPM "update" letter ("PPM Update Letter") to investors, mostly convertible noteholders. The PPM Update Letter recommended that the convertible noteholders convert their notes into equity and they all did.

12. However, the December 2011 PPM and the PPM Update Letter misled investors about Aurum's ownership interest in the Brazilian property and the amount of gold contained in the property. The December 2011 PPM and PPM Update Letter also contained material misrepresentations and omissions concerning, among other things: (a) the use of investor proceeds; (b) test results and financial projections relating to the Brazilian property; (c) the acquisition of other gold properties in Peru; and (d) Crow's bankruptcy and securities litigation background. Furthermore, the PPM Update Letter falsely stated that Aurum had "satisfied the conditions of closing on the Aurum original PPM," referring to the closing conditions of the August 2011 PPM. This representation was false because Aurum never acquired an interest in the Brazilian property, nor did it obtain the required licenses from the Brazilian government or the geological report from a qualified and licensed geologist stating the total gold content in the Brazilian property.

13. As CFO and manager of Aurum, Lana failed to take any steps to ascertain whether the closing conditions in the August 2011 PPM were met. For instance, Lana did not seek any evidence or written confirmation of Brazilian counsel's opinion, the required licenses and the geological report specified in the August 2011 PPM.

14. As CFO, Lana also failed to safeguard investor proceeds against misuse and allowed Clug and Crow unfettered access to investor funds. For instance, Lana knew or should have known that Crow and Clug used a majority of the funds raised from the convertible noteholders to personally benefit themselves instead of using the funds for due diligence activities on the Brazilian property, as promised to investors. Lana also knew or should have known that Crow and Clug used a substantial amount of the investor proceeds from the equity offering to personally benefit themselves while Aurum had failed to fulfill the closing conditions.

15. The Aurum operating agreement annexed to the PPMs required the managers to send to investors annual audited and unaudited balance sheets and income statements. Lana, as Aurum's CFO, had access to these financial statements but failed to provide them to investors.

16. From August 2011 to September 2012, Aurum raised approximately $2.2 million from at least 20 investors in Florida, Connecticut and California.

17. By September 2012, Aurum had substantially depleted the proceeds from investors. Aurum then prepared a new PPM dated September 15, 2012 ("September 2012 PPM") to raise $1 million purportedly to build a mineral processing plant and launch mining operations in Peru. Subsequently, Aurum prepared another PPM dated January 1, 2013 ("January 2013 PPM"), a Confidential Information Memorandum ("CIM"), and an Aurum Business Plan dated January 30, 2013 ("Aurum Business Plan"), to raise an additional $1 million, also purportedly to build a mineral processing plant and launch mining operations in Peru.

18. The September 2012 PPM, January 2013 PPM, CIM, and Aurum Business Plan contained material misrepresentations and omissions about Aurum's ownership interest, test results, financial projections, the timing of production, and cash flow on the Peruvian mineral concessions acquired by Aurum.

19. From September 2012 to November 2013, Aurum raised approximately $1.5 million from at least 10 investors in Florida, Connecticut, California, New Jersey, and the United Kingdom.

20. Furthermore, from May 2012 to July 2013, Aurum prepared and disseminated quarterly reports to "update" existing and prospective Aurum investors. Through these quarterly reports, Aurum misled investors about its ownership interests in various mineral properties in Brazil and Peru, the test results obtained from those properties, and the timing of production and cash flow associated with those properties.

21. Lana was negligent in soliciting investors for Aurum using materially false and misleading documents. Lana was the CFO and a manager of Aurum, and he participated in the review and approval of Aurum's offering documents. As a result, Lana knew or should have known about Crow's bankruptcy and previous securities laws violations, Aurum's failures in Brazil, and Crow and Clug's use of the offering proceeds to benefit themselves in spite of Aurum's failures in Brazil. Due to these red flags, Lana should have investigated whether the offering documents he used to solicit investors for Aurum contained inaccurate or misleading representations. Lana failed to do so.

22. To date, the Aurum investors have not received any return on their investments.

D. VIOLATIONS

Sections 17(a) (2) and 17(a) (3) of the Securities Act prohibit a person, in the offer or sale of any securities, directly or indirectly, to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements make, in light of the circumstances under which they were made, not misleading; or to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser. By his conduct described above, Lana willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act.

E. FINDINGS

Based on the foregoing, the Commission finds that Lana willfully violated Sections 17(a)(2) and 17(a)(3) of the Securities Act.

Undertakings

Lana has undertaken to:

Forego any compensation due to him from Aurum and any entity owned or controlled, directly or indirectly, by either Crow or Clug or both, during the relevant period; and

Cease raising any funds for Aurum and any entity owned or controlled, directly or indirectly, by either Crow or Clug or both.

In determining whether to accept the Offer, the Commission has considered these undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondent Lana's Offer.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Lana shall cease and desist from committing or causing any violations and any future violations of Section 17(a) of the Securities Act.

B. Lana is denied the privilege of appearing or practicing before the Commission as an accountant.

C. After five years from the date of this order, Respondent may request that the Commission consider his reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that Respondent's work in his practice before the Commission will be reviewed either by the independent audit committee of the public company for which he works or in some other acceptable manner, as long as he practices before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

   (a) Respondent, or the public accounting firm with which he is associated, is registered with the Public Company Accounting Oversight Board ("Board") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

   (b) Respondent, or the registered public accounting firm with which he is associated, has been inspected by the Board and that inspection did not identify any criticisms of or potential defects in Respondent's or the firm's quality control system that would indicate that Respondent will not receive appropriate supervision;

   (c) Respondent has resolved all disciplinary issues with the Board, and has complied with all terms and conditions of any sanctions imposed by the Board (other than reinstatement by the Commission); and

   (d) Respondent acknowledges his responsibility, as long as Respondent appears or practices before the Commission as an independent accountant, to comply with all requirements of the Commission and the Board, including, but not limited to, all requirements relating to registration, inspections, concurring partner reviews and quality control standards.

D. The Commission will consider an application by Respondent to resume appearing or practicing before the Commission provided that his state CPA license is current and he has resolved all other disciplinary issues with the applicable state boards of accountancy. However, if state licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Respondent's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

E. Respondent shall pay a civil penalty of $50,000. Payment shall be made in the following installments: $15,000 within ten (10) calendar days of the date of this Order, and $35,000 within one (1) year of the date of this Order. If any payment is not made by the date the payment is required by this Order, the entire outstanding balance, plus any additional interest accrued pursuant to 31 U.S.C. 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Angel E. Lana as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Amelia Cottrell, Associate Regional Director, Division of Enforcement, Securities and Exchange Commission, 200 Vesey Street, Suite 400, Brookfield Place, New York, NY 10281.

F. Such civil money penalty may be distributed pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended ("Fair Fund distribution"). Regardless of whether any such Fair Fund distribution is made, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

G. Respondent acknowledges that the Commission is not imposing a civil penalty in excess of $50,000 based upon his agreement to cooperate in a Commission investigation and/or related enforcement action. If at any time following the entry of the Order, the Division of Enforcement ("Division") obtains information indicating that Respondent knowingly provided materially false or misleading information or materials to the Commission or in a related proceeding, the Division may, at its sole discretion and with prior notice to the Respondent, petition the Commission to reopen this matter and seek an order directing that the Respondent pay an additional civil penalty. Respondent may contest by way of defense in any resulting administrative proceeding whether he knowingly provided materially false or misleading information, but may not: (1) contest the findings in the Order; or (2) assert any defense to liability or remedy, including, but not limited to, any statute of limitations defense.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73855 / December 16, 2014

Admin. Proc. File No. 3-16211

In the Matter of GLOBAL GREEN, INC., NUTRITIONAL HEALTH INSTITUTE LABORATORIES, LLC, and DR. MEHRAN GHAZVINI	ORDER DISMISSING PETITION FOR TERMINATION OF SUSPENSION OF TRADING SECURITIES

We dismiss the Petition for Termination of Suspension of Trading Securities (the "Petition") filed by Global Green, Inc.; Nutritional Health Institute Laboratories, LLC; and Dr. Mehran Ghazvini. The Petition is untimely under Rule of Practice 550.[1]

On September 25, 2014, the Commission issued an order (the "Suspension Order") pursuant to Section 12(k) of the Securities Exchange Act of 1934 that suspended trading in the securities of Global Green, Inc. (GOGC) for ten days.[2] The Suspension Order stated that there was a lack of current and accurate information concerning the issuer and that "[q]uestions have arisen concerning the adequacy and accuracy of press releases concerning the company's operations."[3] By the Suspension Order's terms, the trading suspension terminated on October 8, 2014. The Petition was filed on October 23, 2014, more than two weeks later (and almost a month after petitioners first were on notice of the Suspension Order's issuance).[4]

The disposition of the Petition is controlled by Rule of Practice 550. As we explained in our recent order in *Accredited Business Consolidators Corp.*, the "means for Commission review

1 17 C.F.R. § 201.550.

2 15 U.S.C. § 78*l*(k)(1).

3 *All Grade Mining, Inc.*, 2014 WL 4755265 (Sept. 25, 2014), 79 Fed. Reg. 58399 (Sept. 29, 2014).

4 On September 26, Global Green issued a press release "announc[ing] that the SEC halted trading in its common stock." Global Green, Inc., *Global Green Responds to SEC Action* (Sept. 26, 2014) (last visited December 16, 2014), *available at* http://www.globalgreeninc.com/global-green-responds-to-sec-action. On October 3, five days before the suspension's termination, Global Green filed a Form 8-K, signed by Dr. Ghazvini (who also is the controlling shareholder of Nutritional Health Institute Laboratories, which in turn is the majority shareholder of Global Green), stating that the company "received written notice" of the Suspension Order on September 30 and "intend[ed] to follow appropriate appellate procedures." We take official notice of the Form 8-K pursuant to Rule of Practice 323, 17 C.F.R. § 210.323.

of a Section 12(k)(1)(A) order set forth in our Rules of Practice is the filing of a petition pursuant to Rule 550(a) 'requesting that the [summary] suspension be terminated' while the suspension order is still in effect."[5] A Rule 550 petition must present reasons why the "suspension of trading should not continue."[6] If the suspension is no longer in effect when the petition is filed, the petition is untimely and review of the temporary suspension order is not available.[7] The time limit imposed by Rule 550 promotes the important interests of efficiency and finality in the administrative process, which we have recognized in a variety of other contexts.[8]

We apply Rule 550 here, as we did in *Accredited Business Consolidators*. Petitioners had the opportunity to pursue relief from the trading suspension but failed to timely avail themselves of it.[9] They assert that the Suspension Order was not specific enough to enable them to prepare a meaningful response in that it did not "identify the press releases that are objectionable" or "identify . . . what is inadequate or inaccurate" about them.[10] The procedurally proper way to raise such objections would be to file a timely petition for termination under Rule 550 before the suspension's expiration, as required by our Rules of Practice. Indeed, the Petition requests that the Commission identify the "inadequacies and/or inaccuracies" in the press releases and give petitioners the opportunity to file a supplemental brief before disposing of the matter; nothing stood in the way of petitioners seeking the identical relief from the Commission in a *timely* filed

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5 Exchange Act Release No. 73420, 2014 WL 5386875, at *1 (Oct. 23, 2014) (alteration in original).

6 17 C.F.R. § 201.550(a).

7 *Accredited Business Consolidators*, 2014 WL 5386875, at *2. As in *Accredited Business Consolidators*, "we do not address whether or how relief might be sought with respect to any of the potentially continuing collateral consequences of an already expired temporary suspension order" because petitioners have not requested any such relief. *Id.* at *2 n.19.

8 *See, e.g.*, *Walter V. Gerasimowicz*, Exchange Act Release No. 72133, 2014 WL 1826641, at *2 & nn.18-19 (May 8, 2014) ("[S]trict compliance with filing deadlines facilitates finality and encourages parties to act timely in seeking relief.") (quotation marks omitted); *Pennmont Sec.*, Exchange Act Release No. 61967, 2010 WL 1638720, at *4 & n.21 (Apr. 23, 2010) (similar); *accord Talamantes-Penalver v. INS*, 51 F.3d 133, 137 (8th Cir. 1995) (stating that agency had a "significant" interest in "limiting the time for filing appeals" to a ten-day period).

9 *See supra* note 4. Petitioners do not attempt to justify the late filing of the Petition, so we have no occasion to decide what, if any, circumstances would warrant Commission consideration of an otherwise untimely petition.

10 *Cf. SEC v. Sloan*, 436 U.S. 103, 112 (1978) (holding that Section 12(k) statutorily confers upon the Commission "the power to summarily suspend trading in a security . . . without any . . . findings based upon a record").

petition.[11] If the Commission found it warranted, it could have cured any alleged procedural defect.[12]

We have determined to dismiss the Petition on the ground of untimeliness and without considering the substance of the arguments asserted therein. We find that our decisional process would not be significantly aided by holding a hearing on the matter.[13] Accordingly, it is ORDERED that the Petition for Termination of Suspension of Trading Securities is DISMISSED.

By the Commission.

Brent Fields
Secretary

By: Jill M. Peterson
Assistant Secretary

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11 *See* Rule of Practice 550(b), 17 C.F.R. § 201.550(b) (providing that the Commission has discretion to "request[] additional written submissions" prior to resolving a Rule 550 petition).

12 *E.g.*, *Singh v. Dep't of Homeland Security*, 526 F.3d 72, 77 (2d Cir. 2008) (requiring claim regarding alleged "lack of specificity" in notice initiating removal proceedings to be presented to the agency); *Green v. Baughman*, 214 F.2d 878, 878 (D.C. Cir. 1954) (per curiam) (requiring petitioner to present claim that "charges served on [him] by his agency lacked specificity" to the agency for "administrative determination in the first instance"); *cf. Woodford v. Ngo*, 548 U.S. 81, 89 (2006) (explaining that encouraging parties to properly exhaust the "administrative procedure may produce a useful record for subsequent judicial consideration") (quotation marks omitted).

13 We deny petitioners' motion for hearing. Citing *SEC v. Sloan*, *supra* note 10, petitioners assert that due process requires an opportunity for a hearing whenever a trading suspension exceeds ten days in duration. Their reliance on *Sloan* is misplaced, as the Court held only that trading suspensions summarily issued under Section 12(k) are statutorily limited to a single, ten-business-day period based on any single set of circumstances. The Suspension Order comports with *Sloan*: It expired on October 8, ten business days after issuance and two weeks before the Petition was filed. Petitioners' motion to expedite is denied as moot.

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73854 / December 16, 2014

Admin. Proc. File No. 3-16208

In the Matter of 21st Century Telesis II, Inc., *et al.*	ORDER DISMISSING PROCEEDINGS WITH RESPECT TO ICON PUBLIC LTD. CO.

On October 22, 2014, the Commission instituted administrative proceedings against Icon Public Ltd. Co. ("Icon") and five other registrants under Section 12(j) of the Securities Exchange Act of 1934.[1] The Order Instituting Proceedings ("OIP") alleged that Icon violated periodic reporting requirements because it was delinquent in its periodic filings with the Commission. The OIP ordered a hearing to determine whether these allegations were true and, if so, whether suspension or revocation of the registration of Icon's securities was necessary and appropriate for the protection of investors.

Subsequently, the Division of Enforcement learned that Icon stopped filing periodic reports under one Central Index Key ("CIK") number and began filing periodic reports using a second CIK number. CIK numbers are used on the Commission's computer systems to identify registrants that have filed documents, such as periodic reports, with the Commission.[2] Thus, Icon appeared to be delinquent in its filings when, in fact, the company was not delinquent. Accordingly, the Division filed a motion to dismiss the proceeding on that basis. Icon has not responded to the Division's motion.

It is appropriate to grant the Division's motion because Icon is, and has been, current in its periodic reports.

Accordingly, IT IS ORDERED that this proceeding be dismissed with respect to Icon.

By the Commission.

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

Brent J. Fields
Secretary

1 15 U.S.C. § 78l(j). Proceedings are still pending as to the other registrants.

2 EDGAR Company Filings, available at http://www.sec.gov/edgar/searchedgar/cik.htm.

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3983 / December 17, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16323

In the Matter of **GEORGE Q. STEVENS,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 203(f) OF THE INVESTMENT ADVISERS ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 203(f) of the Investment Advisers Act of 1940 ("Advisers Act") against George Q. Stevens ("Stevens" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 below, which are admitted, and except as otherwise provided herein in paragraph Section V., Respondent consents to the entry of this Order Instituting Administrative Proceedings Pursuant to Section 203(f) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Respondent Stevens, 69 years old, resides in Lacey, Washington and is the managing partner of Stevens Resource Group, LLC ("Stevens Resource"), an unregistered investment adviser. From October 2008 through January 2010, Stevens was associated with Stevens Resource, which acted as an unregistered investment adviser to two unregistered, private investment funds, The Stealth Fund, LLLP ("Stealth") and The Adamas Fund, LLLP ("Adamas").

2. On December 9, 2014, a judgment was entered by consent against Stevens, permanently enjoining him from future violations of Section 17(a) of the Securities Act of 1933, Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, in the civil action entitled *Securities and Exchange Commission v. George Q. Stevens, et al.*, Civil Action Number 14-cv-02427-JDW, in the United States District Court for the Middle District of Florida.

3. The Commission's complaint alleged that from approximately December 2008 through October 2009, Stevens, and others, disseminated to Stealth and Adamas investors and prospective investors offering materials and newsletters containing material misstatements and omissions. Specifically, Stevens, and others, failed to disclose in one version of Stealth's private placement memorandum that Stealth's assets would be used to guarantee loans made by certain related third parties to two portfolio companies, in which Stealth invested. Additionally, Stevens, and others, made false and misleading statements and omissions in newsletters to investors regarding the financial condition of some of Adamas' and Stealth's portfolio companies. Further, Stevens signed investment adviser agreements with Stealth and Adamas, provided investment strategies to these funds, and directed investment decisions for them.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Stevens' Offer.

Accordingly, it is hereby ORDERED pursuant to Section 203(f) of the Advisers Act that Respondent Stevens be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order;

and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73862 / December 17, 2014

ACCOUNTING AND AUDITING ENFORCEMENT
Release No. 3615 / December 17, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16324

In the Matter of **BAKER TILLY HONG KONG LIMITED, ANDREW DAVID ROSS, CPA, and KWOK LAIHA HELENA, CPA,** **Respondents.**	**ORDER INSTITUTING PUBLIC ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 4C AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 102(e) OF THE COMMISSION'S RULES OF PRACTICE, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate that public administrative and cease-and-desist proceedings be, and hereby are, instituted against Baker Tilly Hong Kong Limited ("Baker Tilly"), Andrew David Ross ("Ross"), and Kwok Laiha Helena ("Kwok") (collectively, the "Respondents"), pursuant to Sections 4C[1] and 21C of the Securities

1. Section 4C provides, in relevant part, that:

> The Commission may censure any person, or deny, temporarily or permanently, to any person the privilege of appearing or practicing before the Commission in any way, if that person is found . . . (1) not to possess the requisite qualifications to represent others . . . (2) to be lacking in character or integrity, or to have engaged in unethical or improper professional conduct; or (3) to have willfully violated, or willfully aided and abetted the violation of, any provision of the securities laws or the rules and regulations thereunder.

Exchange Act of 1934 ("Exchange Act") and Rule 102(e)(1)(ii) of the Commission's Rules of Practice.[2]

II.

In anticipation of the institution of these proceedings, Respondents have submitted Offers of Settlement (the "Offers") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over them and the subject matter of these proceedings, which is admitted, and except as provided herein in Section V, Respondents consent to the entry of this Order Instituting Public Administrative and Cease-and-Desist Proceedings Pursuant to Sections 4C and 21C of the Securities Exchange Act of 1934 and Rule 102(e) of the Commission's Rules of Practice, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (the "Order"), as set forth below.

III.

On the basis of this Order and Respondents' Offers, the Commission finds[3] that:

A. SUMMARY

Baker Tilly, a PCAOB-registered audit firm located in Hong Kong, was retained to audit the December 31, 2009, financial statements of China North East Petroleum Holdings Limited ("CNEP"), a Nevada corporation with operations exclusively in the People's Republic of China ("China"). During that audit, from January 2010 until at least September 2010, Baker Tilly and two of its directors (the equivalent of a partner at a U.S. firm), Ross and Kwok, engaged in improper professional conduct, including violations of PCAOB auditing standards, with regard to material related-party transactions among CNEP, its Chief Executive Officer ("CEO"), Wang Hongjun ("Wang"), the CEO's mother, Ju Guizhi ("Ju"), and others.[4] Respondents also violated Section 10A(a)(2) of the Exchange Act, dealing with audit procedures to identify related-party transactions.

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2 Rule 102(e)(1)(ii) provides, in pertinent part, that:

> The Commission may . . . deny, temporarily or permanently, the privilege of appearing or practicing before it . . . to any person who is found . . . to have engaged in unethical or improper professional conduct.

3 The findings herein are made pursuant to Respondents' Offers of Settlement and are not binding on any other person or entity in this or any other proceeding.

4 On November 29, 2012, the Commission filed a lawsuit in the U.S. District Court for the Southern District of New York against CNEP, its Chief Executive Officer (Wang Hongjun), the CEO's mother (Ju Guizhi), and a CNEP vice president (Chao Jiang), alleging fraud and related charges. The complaint also named two relief defendants, Wang's wife and Chao's father, to whom large sums had been transferred from company funds. *See SEC v. China North East Petroleum Holdings Limited et al.*, Case No. 12-cv-8696 (S.D.N.Y.).

During the course of the CNEP audit, Respondents were advised that CNEP had engaged in 176 related-party transactions totaling over $59 million in 2009. Respondents also encountered numerous "red flags" suggesting that these related-party transactions involved a high risk of fraud, e.g., the chairman of CNEP's Audit Committee resigned due to concerns relating to these transactions, and Baker Tilly itself determined that CNEP's internal controls relating to such transactions were seriously deficient. Respondents, however, failed to plan and implement an appropriate audit response to these related-party transactions in compliance with PCAOB standards. Further, contrary to generally accepted accounting principles in the United States of America ("U.S. GAAP"), CNEP's December 31, 2009 financial statements did not disclose the related-party transactions other than as a single entry showing a small, net balance due to the CEO. Nonetheless, Baker Tilly issued an audit report containing an unqualified opinion regarding CNEP's 2009 financial statements. That report, which Respondents knew would be filed with the company's 2009 Form 10-K, inaccurately stated that the audit had been conducted in accordance with PCAOB standards and that CNEP's financial statements fairly presented the company's position and results in conformity with U.S. GAAP.

B. RESPONDENTS

1. **Baker Tilly Hong Kong Limited** ("Baker Tilly") is a PCAOB-registered audit firm based in Hong Kong.

2. **Andrew D. Ross** ("Ross"), age 60, is a subject of the United Kingdom and resides in Hong Kong. Ross is a member of the Hong Kong Institute of Certified Public Accountants ("HKICPA") and the Institute of Chartered Accountants of Scotland. Ross is the managing director of Baker Tilly and is the Chairman of its executive committee. Ross was the lead engagement director on the December 31, 2009 CNEP audit and authorized the issuance of Baker Tilly's audit report. As lead engagement director with primary responsibility for the audit, Ross was ultimately responsible for being satisfied that: (1) the direction, supervision, performance, and review of the audit engagement was in compliance with professional standards, applicable legal and regulatory requirements, and the firm's policies and procedures; (2) the auditor's report was appropriate in the circumstances of the audit engagement; (3) sufficient competent evidential matter had been obtained to support the conclusions reached and the auditor's report to be issued; and (4) the audit team had engaged in appropriate consultation on significant matters.

3. **Kwok Laiha Helena a/k/a Helena Kwok** ("Kwok"), age 47, is a Hong Kong citizen and resides in Hong Kong. Kwok is a member of the HKICPA and is a fellow member of the Association of Chartered Certified Accountants and an international affiliate of the American Institute of Certified Public Accountants. Kwok was a shareholder and director at Baker Tilly and functioned as the director in charge of the 2009 year-end audit of CNEP. Kwok was responsible for the day-to-day supervision of the 2009 audit, but did not have authority to sign the audit report. In particular, following the merger of CNEP's prior auditor with Baker Tilly, Kwok became directly responsible for: (1) planning and designing the audit, (2) supervising the Baker Tilly staff in performing the audit steps, (3) reviewing their work and the workpapers and signing off on those

steps, (4) considering the competence and capabilities of individual engagement team members, (5) addressing significant findings or issues arising during the audit engagement and, if necessary, making appropriate modifications to the planned audit approach, and (6) identifying matters for consultation or consideration by qualified engagement team members during the audit engagement. Kwok essentially had delegated responsibility for overall engagement performance.

C. OTHER RELEVANT ENTITY

4. **China North East Petroleum Holdings Limited** ("CNEP") is a Nevada corporation engaged in oil exploration, production and drilling in the People's Republic of China ("China"). CNEP became a U.S. issuer in April 2004 through a reverse merger with a British Virgin Islands shell corporation. CNEP's common stock was registered with the Commission pursuant to Section 12(b) of the Exchange Act and was listed on the NYSE MKT, LLC ("NYSE"). On July 6, 2012, NYSE filed a Form 25 delisting the common stock effective on July 16, 2012, and deregistering the common stock from Section 12(b) effective on October 4, 2012. Upon deregistration from Section 12(b), the common stock reverted to its previous registration pursuant to Section 12(g) of the Exchange Act. On April 5, 2013, the Commission entered an order pursuant to Section 12(j) of the Exchange Act revoking the registration of each class of CNEP's securities registered pursuant to Section 12 of the Exchange Act.

D. FACTS

CNEP's December 31, 2009 Financial Statements Filed on Form 10-K Failed To Disclose Material Related-Party Transactions

5. CNEP conducts business through four subsidiaries in China: Song Yuan North East Petroleum Technical Services Co., Ltd.; Song Yuan Yu Qiao Oil & Gas Development Co., Ltd.; Song Yuan Tiancheng Drilling Engineering Co., Ltd.; and Changling Longde Oil and Gas Exploration Co., Ltd.

6. From 2004 through 2008, CNEP's annual financial statements were not audited by Baker Tilly, but by another firm also located in Hong Kong (the "Former Auditor"). In late 2009, the Former Auditor and Baker Tilly began discussions regarding a potential merger of the Former Auditor's U.S. audit practice into Baker Tilly. That merger became effective on January 29, 2010, at which time the Former Auditor resigned as CNEP's auditor and CNEP engaged Baker Tilly as the auditor for its 2009 year-end financial statements. At the time of the merger, a majority of the audit field work had been completed by the staff of the Former Auditor, several of whom joined Baker Tilly following the merger.

7. On April 14, 2010, the chairman of CNEP's audit committee raised questions concerning a line item in the draft financial statements indicating that $3.89 million was due to CNEP from a shareholder. The company's chief financial officer ("CFO") indicated that this reflected monies due to the company from another CNEP director, Ju, the mother of CNEP's CEO. Thereafter, the CFO acknowledged to the audit committee that Wang and Ju regularly transferred

cash to and from the company and their personal bank accounts.

8. This information regarding related-party transactions prompted the audit committee to retain a forensic accounting firm to review the $3.89 million balance and evaluate the company's internal controls over such transactions. After receiving a preliminary report from the forensic accounting firm, the Board of Directors placed CEO Wang on leave and accepted his resignation as Chairman of the Board on May 23, 2010. The same day, the Board also accepted his mother's resignation as a director.

9. On July 10, 2010, the forensic accounting firm submitted its final report, which identified 176 related-party transactions totaling approximately $59 million during 2009, and found that there were "critical deficiencies in [CNEP's] internal control procedures" (the "July 2010 Forensic Report"). The $59 million in related-party transactions included approximately $28 million paid from CNEP to Wang and Ju.[5] It also included approximately $11 million that Wang and Ju allegedly loaned to CNEP, as well as expenses paid by Wang and Ju on behalf of CNEP. The report also noted that the approximately $20 million that would have remained due from Wang and Ju at the end of 2009 was reduced to zero through year-end consolidation and post-year-end closing adjustments that lacked supporting documentation or were otherwise questionable.

10. The forensic accounting firm stated in its report that "[o]ur review has found no evidence to suggest that funds transferred to either Ms. Ju or Mr. Wang were withdrawn for her/his personal use, but has identified that funds transferred to the personal accounts of Ms. Ju and Mr. Wang have been recorded . . . and applied to make payments related to the operations of" CNEP. The forensic accounting firm also stated in its report that "[w]hilst our review has involved an analysis of financial information and accounting records, it does not constitute an audit or an assurance assignment in accordance with Hong Kong or International Standards on Auditing, on Review Engagements or on Assurance Engagements and accordingly, no such assurance is provided in this report." Moreover, notwithstanding what the forensic accounting firm wrote in its report, there is substantial evidence that company funds were transferred to company insiders and their family members for personal use.

11. The July 2010 Forensic Report identified numerous additional red flags and internal control deficiencies and failures, including:

- The ability of management to override internal controls and access CNEP's bank accounts.
- Unauthorized related-party transactions, including cash withdrawals, payments to vendors, and investments made by insiders on behalf of CNEP without authorization were possible, in part, because of insufficient verification of payments.

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[5] The approximately $28 million that went from CNEP to Wang and Ju was approximately 41% of CNEP's 2009 reported annual revenues of approximately $68 million.

- Inadequate segregation of duties among employees in accounts payable and cash management areas that could result in the misappropriation of company funds.

- Failure to implement and comply with Chinese Interim Cash Control Regulations and Internal Policy concerning cash disbursements, including the lack of a policy related to amounts that could be advanced to company personnel to make purchases on behalf of the company.

- Incomplete audit trail for the related-party transactions.

- Convoluted and inappropriate account offsets of amounts owed to CNEP by insiders, including Wang and Ju, based on agreements that were largely unsigned and contained contradictory statements or amounts.

- Insufficient internal controls to require written approval for the period-end adjustments could result in intentional or unintentional errors in financial statements.

- Varied explanations and numerous other anomalies were noted in documentation of the transactions related to fixed assets prepayments to suppliers purportedly paid through the Ju's personal account.

12. The July 2010 Forensic Report stated that it was not an audit of the related-party transactions or any other part of the CNEP financial statements. Nevertheless, after receiving the July 2010 Forensic Report on or about July 12, 2010, Ross, Kwok and the engagement team failed to (i) adequately review the report, (ii) adequately revise the firm's audit planning regarding fraud risks, or (iii) audit the material related-party transactions in accordance with PCAOB standards.

13. On May 27, 2010, CNEP announced that its CFO had resigned. The new (acting) CFO was unwilling to sign the management representation letter because he was unfamiliar with CNEP's historical financial information. Ross, Kwok, and the engagement team ultimately accepted a management representation letter signed only by the acting CEO, who had only three weeks earlier been assigned principal financial officer responsibilities. On August 8, 2010, the chairman of CNEP's audit committee resigned, indicating that he believed the company had not adequately addressed the findings of the July 2010 Forensic Report.

14. On September 3, 2010, CNEP's financial statements were filed with the Commission as part of CNEP's 2009 Form 10-K. The material related-party transactions were not disclosed in detail in the notes to the financial statements. CNEP disclosed only that as of December 31, 2009, the company owed a stockholder $89,269. CNEP did not disclose that the stockholder was CEO Wang or that the $89,269 was the net result of 176 separate transactions between the company and Wang or his mother or that they totaled approximately $59 million. Thus, the financial statements and notes thereto provided no information regarding the description of the transactions, the nature of the relationships involved, the amounts involved, the terms and manner of settlement of the transactions, and such other information as may be deemed necessary

to understand the effects of the significant and unusual transactions on the financial statements as required by U.S. GAAP. Nor did the financial statements indicate that many of the transactions involved the CEO's family members.

15. Nonetheless, Baker Tilly issued an audit report containing an unqualified opinion that was filed with CNEP's financial statements in the Form 10-K. In that report, Baker Tilly inaccurately stated that the audit had been conducted in accordance with PCAOB standards and that CNEP's financial statements fairly presented the company's position and results in conformity with U.S. GAAP.

Baker Tilly, Ross, and Kwok Failed to Conduct the CNEP Audit in Accordance with PCAOB Standards

Failed to exercise due professional care and lacked professional skepticism (AU §§ 230 and 334)

16. PCAOB standards require auditors to exercise due professional care in the planning and performance of the audit and the preparation of the report. (AU § 230.01) Auditors should be assigned and supervised commensurate with their level of knowledge, skill, and ability, so that they can evaluate the audit evidence they are examining. The auditor with final responsibility for the engagement should know, at a minimum, the relevant accounting and auditing standards and should be knowledgeable about the client. (AU § 230.06) Auditors must maintain an attitude of professional skepticism, which includes "a questioning mind and a critical assessment of audit evidence." (AU § 230.07) In addition, the auditor should "consider the competency and sufficiency of the evidence. Since evidence is gathered and evaluated throughout the audit, professional skepticism should be exercised throughout the audit process." (AU § 230.08) Additionally, PCAOB standards dealing directly with related-party transactions require that "an auditor should view related-party transactions within the framework of existing [accounting] pronouncements, placing primary emphasis on the adequacy of disclosure." (AU § 334.02)

17. Ross, Kwok, and other Baker Tilly personnel exhibited a lack of understanding of applicable U.S. professional accounting and auditing standards regarding: (i) disclosure of related-party transactions and (ii) audit procedures and documentation. Generally, Ross, Kwok, and the Baker Tilly staff involved in this audit lacked adequate professional training in U.S. GAAP. Ross and Kwok indicated that they received approximately two days of training in U.S. GAAP each year. Kwok had never previously been involved in the audit of a U.S. issuer.

18. Respondents failed to exercise the requisite level of care or perform a critical assessment of the audit evidence. Well before the audit report was issued, they were aware that CNEP was engaged in material related-party transactions, including loans to and from insiders, convoluted offsetting agreements, payments to vendors on behalf of CNEP, investments by insiders on behalf of CNEP, and reimbursements to insiders. Nevertheless, Baker Tilly issued an audit report containing an unqualified opinion even though CNEP failed to properly disclose the

material related-party transactions in its financial statements as required by U.S. GAAP.[6]

19. Respondents also failed to exercise an appropriate level of skepticism about the significant and unusual related-party transactions and the explanations and documentation provided by CNEP. They failed to: (i) obtain an adequate understanding of their nature, purpose and extent; (ii) determine whether such transactions were approved at appropriate levels within the organization; (iii) adequately consider the implications of significant deficiencies in the system of internal controls surrounding related-party transactions; (iv) address the risks associated with routine transfers of significant CNEP funds into the personal bank accounts of insiders; (v) obtain sufficient evidence to substantiate the related-party transactions, including significant post-year-end adjustments; and (vi) resolve inconsistencies in the evidence presented and explanations obtained. There is insufficient evidence in Respondents' workpapers that they questioned these transactions or instructed the audit team that specific testing must be designed to address the risks associated with these unusual transactions.

Failed to adequately plan the audit (AU §§ 311 and 316)

20. Ross, Kwok, and the Baker Tilly engagement team failed to adhere to the PCAOB standards relating to audit planning because they did not obtain adequate knowledge of CNEP's business or properly consider the risks of material misstatement due to fraud at CNEP.

21. An auditor must adequately plan the audit and properly supervise assistants. (AU § 311.01) In planning the audit, the auditor should obtain a level of knowledge of the entity's business that will enable him to plan and perform his audit in accordance with PCAOB Standards. As the audit progresses, changed conditions may make it necessary to modify planned audit procedures. (AU § 311.05.) The auditor should obtain an understanding the events, transactions, and practices that, in his judgment, may have a significant effect on the financial statements. Knowledge of the entity's business helps the auditor to, among other things, identify areas that may need special consideration, assess conditions under which accounting data are produced, processed, reviewed and accumulated within the organization, and evaluate the reasonableness of management representations. (AU § 311.06.) In planning the audit, the auditor should also consider, among other matters, the entity's accounting policies and procedures, and planned assessed level of control risk. (AU § 311.03.)

22. The auditor must plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. (AU § 316.01) The audit engagement team, including the auditor with final responsibility

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6 In particular, Financial Accounting Standards Board Accounting Standards Codification Topic 850 ("ASC 850"), formerly known as Statement of Financial Accounting Standards No. 57, provides that financial statements shall include disclosures of material related-party transactions, including a description of the transactions, the nature of the relationships involved, the dollar amount of the transactions, the terms and manner of settlement of amounts due from or to related parties (if not otherwise apparent), and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements.

for the audit, is required to discuss the risk of material misstatement due to fraud and obtain information needed to identify such risk. This includes the obligation to make inquiries of management, those charged with governance, and others within the company regarding such risk. (AU § 316, at .14-.27.)

23. Respondents failed to obtain an adequate understanding of CNEP's business and business environment, including its accounting policies and procedures, internal controls, and the risk of material error or fraud from related-party transactions. Kwok did not meet any CNEP personnel in person until 2011. Ross never visited CNEP's offices or any of its field operations, and never spoke to Baker Tilly's main contact, the CFO, prior to finalizing the 2009 audit opinion and therefore was not knowledgeable about the client or its business.

24. Respondents failed to adequately plan the audit. There is no indication in the workpapers that Ross reviewed the audit planning documents. As the audit progressed, new information and changed conditions should have caused Respondents to re-evaluate and modify the procedures in accordance with AU 311.05. However, the audit plan was not revised after the Respondents received the July 2010 Forensic Report, which noted that the 176 related-party transactions occurred during 2009.

25. Ross and Kwok failed to consider numerous indications of possible fraud risk in the overall risk analysis and audit planning. Correspondingly, Respondents failed to develop audit procedures tailored to the true risks presented by the related-party transactions. In particular, related-party transactions were not identified as a risk area.

Failed to design procedures tailored to the risk of misstatement and failed to properly document audit risk (AU §§ 311 and 312)

26. The auditor is required to perform risk assessment procedures when planning and performing an audit of financial statements in accordance with PCAOB Standards. (AU § 312.01) Ordinarily, higher risk requires more experienced personnel or more extensive supervision, during both the planning and the conduct of the engagement. Additionally, higher risk may cause the auditor to expand the procedures applied or modify the procedures to obtain more persuasive evidence. (AU § 312.17)

27. Further, the auditor should consider conditions that may require extension or modification of audit tests, such as the existence of related-party transactions. (AU § 311.03g) An audit of financial statements is a cumulative process and the audit evidence obtained may cause the auditor to modify the planned procedures. (AU § 312.33)

28. In view of the information in the July 2010 Forensic Report, including the significant deficiencies in internal controls surrounding the related-party transactions and the ability of management to override internal controls to access CNEP's bank accounts, Respondents should have considered identifying additional risk areas and requiring corresponding additional testing.

Failed to obtain sufficient competent evidential matter and properly audit related-party transactions (AU §§ 326, 330, and 334)

29. An auditor must obtain sufficient competent evidential matter to provide a reasonable basis for an audit opinion. (AU § 326.01) In selecting particular substantive tests to achieve the audit objectives, an auditor considers, among other things, the risk of material misstatements. (AU § 326.11) Evidential matter from independent sources outside the issuer provides greater assurance of reliability than information obtained solely from within the entity. (AU § 326.21) With respect to related-party transactions, after an auditor identifies related-party transactions, he or she should apply the procedures considered necessary to obtain satisfaction concerning the purpose, nature, and extent of those transactions and their effect on the financial statements. This may include taking the steps necessary to obtain "an understanding of the business purpose of the transaction" and examining supporting documentation, such as invoices and copies of contracts. (AU § 334.09) Where disclosure of a transaction is required, the auditor must satisfy himself that the transaction is adequately disclosed in the financial statements. (AU § 334.11) The higher the auditor's assessment of risk regarding related-party transactions, the more extensive or effective the audit tests should be. (AU § 9334.19)

30. If an entity has entered into an unusual or complex transaction and the combined assessed level of inherent and control risk is high, the auditor should consider confirming the terms of the transaction with the other parties. (AU § 330.08) The auditor should assess whether the evidence provided by confirmations reduces audit risk for the related assertions to an acceptably low level. In making that assessment, the auditor should consider the materiality of the account balance and the control risk assessment. If the evidence provided by confirmations is not sufficient, additional procedures should be performed. (AU § 330.09)

31. Respondents failed to obtain sufficient evidence regarding CNEP's related-party transactions to support an unqualified audit opinion. Respondents failed to identify related parties, failed to identify all related-party transactions, and failed to perform adequate procedures to gain an understanding of the business purposes, nature and impact of the material related-party transactions that were identified. Respondents also failed to obtain audit evidence that would justify CNEP's failure to adequately disclose the material related-party transactions.

32. CNEP engaged in approximately $59 million in related-party transactions in 2009. However, the scope of the Hong Kong accounting firm's engagement and its July 2010 Forensic Report focused on the $3.89 million balance identified by the audit committee chairman. Baker Tilly's workpapers do not reflect that Ross Kwok, or anyone on the engagement team made meaningful inquiry as to the nature or business purpose of the other material related-party transactions, or that they performed sufficient substantive procedures to verify those transactions.

33. Post year-end closing adjustments significantly reduced the amounts that Wang and Ju owed CNEP; however, Respondent's testing in this area was limited. According to the July 2010 Forensic Report, the post year-end adjustments included transactions to record $5.0 million in "balance transfers" due from CNEP to Wang and Ju and $6.7 million related to the "amount paid

by Ms. Ju for acquiring Tian Cheng." Nothing in Respondents' workpapers indicates that they applied sufficient procedures to substantiate these post year-end adjustments.

34. Another of the 176 related-party transaction involved Wang's purported capital infusion of $4.6 million into CNEP's subsidiary Song Yuan Technical on September 23, 2009. However, according to the bank statement for the account in which CNEP's 2009 offering proceeds were deposited, the $4.6 million was transferred from CNEP, not Wang. Baker Tilly's workpapers contain conflicting accounts of the source of the $4.6 million. Respondents failed to determine and document the true source of the $4.6 million before issuing the audit report containing an unqualified opinion.

35. To test whether Wang was owed substantial sums by CNEP, Respondents sent the confirmation papers to Wang himself. Wang was not a third-party and, given the risk, this "confirmation process" was not sufficient to determine the completeness, existence or accuracy of the purported debt to Wang. As such, additional evidence should have been obtained but was not.

Failed to prepare and retain adequate audit documentation (AS 3)

36. PCAOB Auditing Standard ("AS") No. 3 requires that audit documentation contain sufficient information to enable an experienced auditor, having no previous connection with the engagement, to understand: the procedures performed; the results and evidence obtained; the conclusions reached; who performed and reviewed the work; and the dates such work was completed and reviewed. (AS 3.06) Respondents failed to comply with these requirements.

37. The audit documentation maintained by Ross, Kwok, and the Baker Tilly engagement team is not sufficient to enable an experienced auditor to understand the "nature, timing, extent and results of audit procedures performed" in a variety of areas. The work papers frequently do not reflect the name of the preparer, the date the work was done, the date the papers were prepared, or the date the papers were reviewed.

38. The audit documentation does not adequately reflect Respondents' findings and conclusions regarding the related-party transactions, including post year-end adjustments. Nor do the workpapers address the fundamental questions of whether CNEP was required by U.S. GAAP to disclose the material related-party transactions in its financial statements.

39. Respondents' workpapers do not contain sufficient evidence with respect to the accounts payable and related payments by Ju purportedly paid to reduce amounts she owed to CNEP. The main focus of the July 2010 Forensic Report was the $3.89 million of vendor payments purportedly made by Ju to eight suppliers on behalf of the company.

E. VIOLATIONS

Rule 102(e) and Section 4C of the Exchange Act

40. As a result of the conduct described above, Respondents engaged in improper professional conduct within the meaning of Section 4C of the Exchange Act and Rule 102(e)(1)(ii) of the Commission's Rules of Practice. These provisions provide, in pertinent part, that the Commission may censure or deny, temporarily or permanently, the privilege of appearing or practicing before the Commission to any person who is found by the Commission to have engaged in improper professional conduct.

41. Section 4C(b) and Rule 102(e)(1)(iv) define improper professional conduct with respect to persons licensed to practice as accountants. Pursuant to these provisions, "improper professional conduct" includes two types of negligent conduct: (1) a single instance of highly unreasonable conduct that results in a violation of professional standards in circumstances in which heightened scrutiny is warranted; or (2) repeated instances of unreasonable conduct, each resulting in violations of professional standards, that indicate a lack of competence.

42. Ross's and Kwok's failures to abide by PCAOB standards in the audit of CNEP's year-end financial statements for 2009 constitute repeated instances of unreasonable conduct, and also satisfy the highly unreasonable conduct standard.

43. Baker Tilly's failures to abide by PCAOB standards in the audit of CNEP's year-end financial statements for 2009 satisfy the one instance of highly unreasonable conduct standard.

Respondents Violated Section 10A(a)(2) of the Exchange Act

44. Section 10A(a)(2) of the Exchange Act requires each audit conducted of an issuer by a registered public accounting firm to include "procedures designed to identify related-party transactions that are material to the financial statements or otherwise require disclosure therein." No showing of scienter is necessary to establish a violation of Section 10A. *See SEC v. Solucorp Indus., Ltd.,* 197 F. Supp. 2d. 4, 10-11 (S.D.N.Y. 2002).

45. In connection with the 2009 CNEP audit, Respondents violated Section 10A(a)(2) of the Exchange Act by failing to plan, design, and carry out audit procedures to identify CNEP's material related-party transactions that required disclosure in the financial statements.

F. FINDINGS

46. Based on the forgoing, the Commission finds that Baker Tilly, Ross, and Kwok engaged in improper professional conduct pursuant to Rule 102(e)(1)(ii) of the Commission's Rules of Practice and Section 4C of the Exchange Act.

47. Additionally, the Commission finds that Baker Tilly, Ross, and Kwok violated Section 10A(a)(2) of the Exchange Act.

G. UNDERTAKINGS

Baker Tilly Shall Retain an Independent Consultant

47. Baker Tilly has undertaken to retain, within thirty days after the entry of this Order, an independent consultant ("Independent Consultant"), not unacceptable to the Commission staff. The Independent Consultant will review and evaluate the audit and interim review policies and procedures of Baker Tilly regarding: (i) identifying and disclosing related-party transactions; (ii) training in client fraud detection; (iii) exercising due professional care and professional skepticism; (iv) audit planning; (v) performing proper risk assessment; (vi) designing procedures tailored to the risk of misstatement; (vii) obtaining sufficient appropriate audit evidence; (viii) document retention; (ix) third-party confirmations; (x) work paper sign-off and dating; and (xi) adequate audit documentation. The Independent Consultant's review and evaluation will assess the forgoing areas to determine whether Baker Tilly's policies and procedures are adequate and sufficient to ensure compliance with Commission regulations and with PCAOB standards and rules. Baker Tilly will cooperate fully with the Independent Consultant and will provide reasonable access to firm personnel, information, and records as the Independent Consultant may reasonably request for the Independent Consultant's reviews and evaluations. Baker Tilly will provide to the Commission staff a copy of the engagement letter detailing the scope of the Independent Consultant's responsibilities.

48. Within sixty days of being retained, the Independent Consultant will issue a written report ("Report") to Baker Tilly: (a) summarizing the Independent Consultant's review and evaluation; and (b) making recommendations, where appropriate, reasonably designed to ensure that audits conducted by Baker Tilly comply with Commission regulations and with PCAOB standards and rules. The Independent Consultant will provide a copy of the Report to the Commission staff and the PCAOB staff when the Report is issued.

49. Baker Tilly will adopt, as soon as practicable, all recommendations of the Independent Consultant in the Report. Provided, however, that within thirty days of issuance of the Report, Baker Tilly may advise the Independent Consultant in writing of any recommendation that it considers to be unnecessary, unduly burdensome, or impractical. Baker Tilly need not adopt any such recommendation at that time, but instead may propose in writing to the Independent Consultant and the Commission Staff an alternative policy or procedure designed to achieve the same objective or purpose. Baker Tilly and the Independent Consultant will engage in good-faith negotiations in an effort to reach agreement on any recommendations objected to by Baker Tilly.

50. In the event that the Independent Consultant and Baker Tilly are unable to agree on an alternative proposal within thirty days, Baker Tilly will abide by the determinations of the Independent Consultant.

51. Within sixty days of issuance of the Report, but not sooner than thirty days after a copy of the Report is provided to the Commission staff, Baker Tilly will certify to the Staff in writing that it has adopted and has implemented or will implement all recommendations of the Independent Consultant ("Certification of Compliance"). Baker Tilly will provide a copy of the Certification of Compliance to the PCAOB staff.

52. Baker Tilly will require the Independent Consultant to enter into an agreement that provides that, for the period of engagement and for a period of two years from completion of the engagement, the Independent Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with Baker Tilly, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Consultant in performance of his/her duties under this Order shall not, without prior written consent of the Division of Enforcement, enter into any employment, consultant, attorney-client, auditing or other professional relationship with Baker Tilly, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

53. Baker Tilly shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission staff may make reasonable requests for further evidence of compliance, and Baker Tilly agrees to provide such evidence. The certification and supporting material shall be submitted to Antonia Chion, Associate Director, Division of Enforcement, Securities and Exchange Commission, 100 F St., N.E., Washington, D.C. 20549-5720B SP2, with a copy to the Office of Chief Counsel of the Enforcement Division, no later than sixty (60) days from the date of the completion of the undertakings.

<u>Baker Tilly Shall Not Accept New Audit Clients</u>

54. Baker Tilly will not accept any new U.S. issuer audit clients between the date of this Order and the issuance of the Certification of Compliance by the Independent Consultant.

<u>Baker Tilly Shall Provide Notice to its Current Audit Clients</u>

55. Within 15 days of the entry of this order, Baker Tilly will provide notice of this settlement to its current U.S. audit clients.

<u>Respondents Shall Cooperate with the</u>
<u>Commission's Investigation and Related Litigation</u>

56. Baker Tilly, Ross, and Kwok hereby undertake that they shall cooperate fully with the Commission in any and all investigations, litigations, administrative or other proceedings

commenced by the Commission or to which the Commission is a party relating to or arising from the matters described in this Order. In connection with such investigations, litigation, administrative or other proceedings, the Respondents agree to the following: (i) to produce, without service of a notice or subpoena, any and all documents and other materials and information as requested by the Commission; (ii) to appear and testify without service of a notice or subpoena in such investigations, interviews, depositions, hearings and trials, at such times and places as reasonably requested by the Commission; and (iii) to respond promptly to all inquiries from the Commission. In determining whether to accept the Offers, the Commission has considered these undertakings.

IV.

In view of the foregoing, the Commission deems it appropriate to impose the sanctions agreed to in Respondents' Offers.

Accordingly, it is hereby ORDERED, effective immediately, that:

A. Baker Tilly, Ross, and Kwok shall cease and desist from committing or causing any violations and any future violations of Section 10A(a)(2) of the Exchange Act.

B. Baker Tilly is censured.

C. Ross and Kwok are denied the privilege of appearing or practicing before the Commission as accountants.

D. After three years from the date of this order, Ross and/or Kwok may request that the Commission consider their reinstatement by submitting an application (attention: Office of the Chief Accountant) to resume appearing or practicing before the Commission as:

1. a preparer or reviewer, or a person responsible for the preparation or review, of any public company's financial statements that are filed with the Commission. Such an application must satisfy the Commission that their work in their practice before the Commission will be reviewed either by the independent audit committee of the public company for which they work or in some other acceptable manner, as long as they practice before the Commission in this capacity; and/or

2. an independent accountant. Such an application must satisfy the Commission that:

    (a) Ross or Kwok, or the public accounting firm with which he or she is associated, is registered with the Public Company Accounting Oversight Board ("PCAOB") in accordance with the Sarbanes-Oxley Act of 2002, and such registration continues to be effective;

(b) Ross or Kwok, or the registered public accounting firm with which he or she is associated, has been inspected by the PCAOB and that inspection did not identify any criticisms of or potential defects in the quality control system relating to the work of Ross or Kwok that would indicate that Ross or Kwok will not receive appropriate supervision;

(c) Ross and/or Kwok have resolved all disciplinary issues with the PCAOB, and has complied with all terms and conditions of any sanctions imposed by the PCAOB (other than reinstatement by the Commission); and

(d) Ross and/or Kwok acknowledges his or her responsibility, as long as they appear or practice before the Commission as an independent accountant, to comply with all requirements of the Commission and the PCAOB, including, but not limited to, all requirements relating to registration, inspections, engagement quality reviews, and quality control standards.

E. The Commission will consider an application by Ross and/or Kwok to resume appearing or practicing before the Commission provided that his or her CPA license is current and he or she has resolved all other disciplinary issues with the applicable boards of accountancy. However, if CPA licensure is dependent on reinstatement by the Commission, the Commission will consider an application on its other merits. The Commission's review may include consideration of, in addition to the matters referenced above, any other matters relating to Ross's or Kwok's character, integrity, professional conduct, or qualifications to appear or practice before the Commission.

F. Baker Tilly shall, within 30 days of the entry of this Order, pay disgorgement of $75,000, which represents profits gained as a result of the conduct described herein, and prejudgment interest of $9,101 to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600.

G. Ross and Kwok shall, within 30 days of the entry of this Order, pay civil money penalties in the amounts of $20,000 and $10,000, respectively, to the Securities and Exchange Commission. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717.

H. Payments ordered in paragraphs F and G above must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Baker Tilly, Ross, or Kwok as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Antonia Chion, Division of Enforcement, Securities and Exchange Commission, 100 F St., NE, Washington, DC 20549.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. §523, the findings in this Order are admitted by Respondents, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. §523(a)(19).

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR PART 230 AND 240

Release No. 33-9693; 34-73876; File No. S7-12-14]

RIN 3235-AL40

CHANGES TO EXCHANGE ACT REGISTRATION REQUIREMENTS TO IMPLEMENT TITLE V AND TITLE VI OF THE JOBS ACT

AGENCY: Securities and Exchange Commission.

ACTION: Proposed rule.

SUMMARY: We are proposing amendments to our rules to implement Title V and Title VI of the Jumpstart Our Business Startups Act (the "JOBS Act"). The proposed amendments would revise rules adopted under Section 12(g) of the Securities Exchange Act of 1934 (the "Exchange Act") to reflect the new, higher thresholds for registration, termination of registration and suspension of reporting that were set forth in the JOBS Act. The proposed rules also would apply the thresholds specified for banks and bank holding companies to savings and loan holding companies. In addition, the proposed amendments would revise the definition of "held of record" in Exchange Act Rule 12g5-1, in accordance with the JOBS Act, to exclude certain securities held by persons who received them pursuant to employee compensation plans and establish a non-exclusive safe harbor for determining whether securities are "held of record" for purposes of registration under Exchange Act Section 12(g).

DATES: Comments should be received on or before [insert date 60 days after publication in the Federal Register].

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/proposed.shtml);
- Send an email to rule-comments@sec.gov. Please include File Number S7-12-14 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

- Send paper comments to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number S7-12-14. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/proposed.shtml). Comments are also available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549-1090 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Steven G. Hearne, Senior Special Counsel, at (202) 551-3430, or Anne Krauskopf, Senior Special Counsel, at (202) 551-3500, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

SUPPLEMENTARY INFORMATION: We are proposing amendments to Rules 3b-4,[1] 12g-1,[2] 12g-2,[3] 12g-3,[4] 12g-4,[5] 12g5-1,[6] and 12h-3[7] under the Exchange Act[8] and an amendment to Rule 405[9] under the Securities Act of 1933 (the "Securities Act").[10]

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[1] 17 CFR 240.3b-4.

[2] 17 CFR 240.12g-1.

[3] 17 CFR 240.12g-2.

[4] 17 CFR 240.12g-3.

[5] 17 CFR 240.12g-4.

[6] 17 CFR 240.12g5-1.

[7] 17 CFR 240.12h-3.

[8] 15 U.S.C. 78a et seq.

[9] 17 CFR 230.405.

[10] 15 U.S.C. 77a et seq.

I. INTRODUCTION

Prior to the enactment of the JOBS Act,[11] Section 12(g) of the Exchange Act[12] required an issuer to register a class of its equity securities if, at the end of the issuer's fiscal year, the securities were "held of record" by 500 or more persons and the issuer had total assets exceeding $1 million.[13] Under Section 12(g) and the Commission's rules prior to the JOBS Act amendments, an issuer that had a class of equity securities registered under Section 12(g) was able to terminate that registration if the number of record holders of that class fell below 300, or the number of record holders of that class

11 Pub. L. No. 112-106, 126 Stat. 325 (Apr. 5, 2012).

12 15 U.S.C. 78l(g). Congress enacted Section 12(g) in 1964 following the release of a study of the securities markets conducted by the staff of the Commission in the early 1960s, which was commissioned by Congress to serve as a basis for legislation. Report of Special Study of Securities Markets of the Securities and Exchange Commission, H.R. Doc. No. 88-95 (1963). Section 12(g) was enacted to "improve investor protection by extending to the larger companies in the over-the-counter market the registration, reporting, proxy solicitation, and insider trading requirements ... applicable to companies listed on an exchange." Report of the Committee on Banking and Currency to Accompany, S.1642, S. Rep. No. 88-379 (1963) at 1.

13 See 15 U.S.C. 78l(g)(1). The Commission has the authority, under Section 12(h), to raise the asset threshold for Section 12(g) registration. 15 U.S.C. 78l(h). The Commission raised the asset threshold for Section 12(g) registration from $1 million to $3 million in 1982, $5 million in 1986 and $10 million in 1996. See System of Classification for Purposes of Exempting Smaller Issuers From Certain Reporting and Other Requirements, Release No. 34-18647 (Apr. 15, 1982) [47 FR 17046 (Apr. 21, 1982)], Reporting by Small Issuers, Release No. 34-23406 (Jul. 8, 1986) [51 FR 25360 (Jul. 14, 1986)], and Relief From Reporting by Small Issuers, Release No. 34-37157 (May 1, 1996) [61 FR 21353 (May 9, 1996)]. For the thresholds applicable to foreign private issuers, see infra note 84 and the discussion in the following text.

fell below 500 and the issuer's assets were no more than $10 million at the end of each of its last three fiscal years.[14]

Exchange Act Section 15(d)[15] requires an issuer with an effective registration statement under the Securities Act to file the same reports as an issuer with a registered class of securities under Exchange Act Section 12. Prior to the enactment of the JOBS Act, an issuer's reporting obligation was automatically suspended under Section 15(d)(1) if, on the first day of any fiscal year other than the year in which the registration statement became effective, there were fewer than 300 holders of record of the class of securities offered under the registration statement.

The JOBS Act amended Sections 12(g) and 15(d) of the Exchange Act to adjust the thresholds for registration, termination of registration and suspension of reporting.[16] Specifically, Section 501 of the JOBS Act[17] amended Section 12(g)(1) of the Exchange Act to require an issuer to register a class of equity securities (other than exempted securities) within 120 days after its fiscal year end if, on the last day of its fiscal year, the issuer has total assets of more than $10 million and the class of equity securities is "held of record" by either (i) 2,000 persons, or (ii) 500 persons who are not accredited investors. Section 601 of the JOBS Act[18] further amended Exchange Act Section 12(g)(1) to require an issuer that is a bank or a bank holding company, as defined in

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14 See 15 U.S.C. 78l(g)(4) and 17 CFR 240.12g-4(a).

15 15 U.S.C. 78o(d).

16 The changes to Exchange Act Sections 12(g)(1), 12(g)(4) and 15(d)(1) were effective upon enactment of the JOBS Act and do not require any Commission action. We are proposing amendments to our rules to reflect the new, higher thresholds provided by the JOBS Act in our rules and to implement the required safe harbor for securities received pursuant to employee compensation plans.

17 Pub. L. No. 112-106, Sec. 501, 126 Stat. 326 (Apr. 5, 2012).

18 Pub. L. No. 112-106, Sec. 601, 126 Stat. 326 (Apr. 5, 2012).

Section 2 of the Bank Holding Company Act of 1956,[19] to register a class of equity securities (other than exempted securities) within 120 days after the last day of its first fiscal year ended after the effective date of the JOBS Act if, on the last day of its fiscal year, the issuer has total assets of more than $10 million and the class of equity securities is "held of record" by 2,000 or more persons. Section 601 of the JOBS Act also amended Exchange Act Section 12(g)(4) and Exchange Act Section 15(d)(1)[20] to enable an issuer that is a bank or a bank holding company to terminate the registration of a class of securities under Section 12(g) or suspend reporting under Section 15(d)(1) if that class is held of record by less than 1,200 persons. For other issuers, the threshold in Section 12(g)(4) for termination of registration and in Section 15(d)(1) for suspension of reporting remains at 300.

Section 502 of the JOBS Act[21] amended Exchange Act Section 12(g)(5)[22] to exclude from the definition of "held of record," for the purposes of determining whether an issuer is required to register a class of equity securities, securities that are held by persons who received them pursuant to an "employee compensation plan" in transactions exempted from the registration requirements of Section 5 of the Securities Act.[23] Section 503 of the JOBS Act[24] instructed the Commission to revise the definition of "held of record" pursuant to Exchange Act Section 12(g)(5) to implement the amendment made by Section 502 of the JOBS Act, and to create a safe harbor for issuers when determining

19 12 U.S.C. 1841.

20 15 U.S.C. 78o(d)(1).

21 Pub. L. No. 112-106, Sec. 502, 126 Stat. 326 (Apr. 5, 2012).

22 15 U.S.C. 78l(g)(5).

23 15 U.S.C. 77e.

24 Pub. L. No. 112-106, Sec. 503, 126 Stat. 326 (Apr. 5, 2012).

whether holders received their securities pursuant to an "employee compensation plan" in a transaction exempted from the registration requirements of Section 5 of the Securities Act.

We believe that the increased registration threshold established by the JOBS Act is intended to permit issuers to defer Exchange Act registration until issuers have a larger shareholder base. In connection with the amendments made by Title V and Title VI of the JOBS Act, we are proposing to amend our rules to reflect the new, higher registration, termination of registration and suspension of reporting thresholds under revised Exchange Act Sections 12(g)(1), 12(g)(4) and 15(d)(1). We also are proposing to permit savings and loan holding companies to register, terminate registration and suspend reporting using the same thresholds that apply to banks and bank holding companies. Finally, we are proposing to amend Exchange Act Rule 12g5-1 to reflect the amendment to Exchange Act Section 12(g)(5) and establish a non-exclusive safe harbor that issuers may follow when determining if securities held by persons who received them pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the Securities Act may be excluded when calculating the number of the issuer's holders of record when determining whether they are required to register under Exchange Act Section 12(g)(1).

After enactment of the JOBS Act, we sought comment from the public prior to the issuance of a proposing release. We have considered the pre-proposal comment letters received to date on Title V and Title VI of the JOBS Act, and we are requesting comment on various issues relating specifically to the proposed amendments.[25] In this release, we

25 To facilitate public input on JOBS Act rulemaking before the issuance of rule proposals, the Commission invited members of the public to make their views known on various JOBS Act

are proposing rule amendments to implement and address issues specifically related to Title V and Title VI of the JOBS Act. We recognize that commenters have urged us to consider and propose additional amendments. For example, several commenters have recommended that the Commission make rule revisions related to the use of the term "accredited investor" or permitting other issuers to register, terminate registration and suspend reporting using the same thresholds that apply to banks and bank holding companies.[26] We have considered the suggestions made by these commenters, but at this time we are not proposing amendments that extend substantially beyond reflecting the new statutory requirements.

II. PROPOSED AMENDMENTS RELATING TO EXCHANGE ACT REPORTING THRESHOLDS

A. Application of the Increased Thresholds for Registration and Reporting Obligations

As a result of the JOBS Act changes to Exchange Act Sections 12(g)(1), 12(g)(4) and 15(d), we are proposing changes to Exchange Act Rules 12g-1, 12g-2, 12g-3, 12g-4 and 12h-3, which are the rules that govern the mechanics relating to registration, termination of registration under Section 12(g) and suspension of reporting obligations under Section 15(d). These rules currently reflect the prior holder of record statutory

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initiatives in advance of any rulemaking by submitting comment letters to the Commission's website at http://www.sec.gov/spotlight/jobsactcomments.shtml. Comment letters received to date on Title V of the JOBS Act are available at http://www.sec.gov/comments/jobs-title-v/jobs-title-v.shtml and on Title VI of the JOBS Act at http://www.sec.gov/comments/jobs-title-vi/jobs-title-vi.shtml.

26 See Section II.C. relating to the term "accredited investor." See also letters from Wilmer Hale (June 25, 2012), and Ledgewood, P.C. (Sept. 12, 2012) on behalf of their respective clients, a real estate investment trust and a real estate limited partnership, requesting that the Commission use its exemptive authority to revise the holder of record threshold to treat non-bank issuers similarly to banks and bank holding companies.

thresholds in Sections 12(g) and 15(d). We are proposing to amend these rules to reflect the new thresholds set forth in the JOBS Act.

Exchange Act Rule 12g-1 currently provides that an issuer shall be exempt from the registration requirements if, on the last day of its most recent fiscal year, it had total assets not exceeding $10 million. JOBS Act Section 501 amended Section 12(g)(1) to expressly include the $10 million asset threshold. We are proposing to revise Rule 12g-1 to reflect the asset and holder of record thresholds established by Titles V and VI of the JOBS Act relating to the requirement to register a class of equity securities under the Exchange Act. The revision would additionally remove an outdated reference currently contained in the rule.[27]

As noted above, Section 601 of the JOBS Act amended Exchange Act Section 12(g)(4) to raise the threshold at which an issuer that is a bank or a bank holding company may terminate registration of a class of equity securities from 300 to 1,200 holders of record. Section 601 similarly amended Exchange Act Section 15(d)(1) by providing for an automatic suspension of the duty to file reports for a bank or bank holding company with respect to a class of equity security that is held of record by less than 1,200 persons at the beginning of its fiscal year, provided that the bank or bank holding company did not have a Securities Act registration statement that became effective during that year.

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27 Under Exchange Act Rule 12g-1, foreign private issuers may not rely on the exemption from registration provided in that rule if their securities are quoted on an automated inter-dealer quotation system. The NASDAQ Stock Market was the only automated inter-dealer quotation system in existence when this provision was adopted and has subsequently registered as a securities exchange with the Commission. See In the Matter of the Application of the Nasdaq Stock Market LLC for Registration as a National Securities Exchange; Findings, Opinion and Order of the Commission, Release No. 34-53128 (Jan. 13, 2006) [71 FR 3550 (Jan. 23, 2006)]. As a result, the reference to an automated inter-dealer quotation system is no longer necessary and we are proposing to remove it.

As currently in effect, Exchange Act Rules 12g-2 and 12g-3 reflect the holders of record thresholds in the Exchange Act for terminating registration and suspending reporting that existed prior to the JOBS Act amendments and not the new thresholds for banks and bank holding companies. Specifically,

- Rule 12g-2 addresses securities deemed to be registered pursuant to Section 12(g)(1) upon termination of the exemption pursuant to Section 12(g)(2)(A) or (B)[28] and establishes a 300-person threshold for such a class of securities to be registered under Section 12(g).
- Rule 12g-3 addresses the 300-person threshold for the registration of securities of successor issuers under Section 12(b) or Section 12(g).

In addition, although the statutory provisions of Exchange Act Section 12(g) and 15(d) do not suspend reporting obligations immediately when an issuer reaches the designated threshold, Exchange Act Rules 12g-4 and 12h-3 permit issuers to immediately suspend their duty to file periodic and current reports. These rules, however, reflect the thresholds in Sections 12(g) and 15(d) prior to the JOBS Act amendments and not the new threshold for banks and bank holding companies. Specifically,

- Rule 12g-4(a) provides that termination of registration under Section 12(g) shall take effect in 90 days, or such shorter period as the Commission determines, after the issuer certifies on Form 15[29] that the class of securities is held by less than 300 persons, or 500 persons where the total assets of the

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28 Section 12(g)(2)(A) [15 U.S.C. 78l(g)(2)(A)] provides an exemption from Section 12(g) registration while the class of securities is listed and registered on a national securities exchange under Exchange Act Section 12(b) [15 U.S.C. 78l(b)]. Section 12(g)(2)(B) [15 U.S.C. 78l(g)(2)(B)] provides an exemption for securities issued by registered investment companies.

29 17 CFR 249.323.

issuer have not exceeded $10 million on the last day of each of the preceding three years.

- Rule 12g-4(b) provides that the duty to file current and periodic reports under Exchange Act Section 13(a)[30] for that class of securities is suspended immediately upon the filing of a certification on Form 15 provided that the issuer has less than 300 holders of record, or 500 holders of record where the issuer's total assets have not exceeded $10 million on the last day of each of the preceding three years.
- Rule 12h-3 provides that the duty to file current and periodic reports under Section 13(a) pursuant to Section 15(d) for that class of securities is suspended immediately upon the filing of a certification on Form 15, provided that:
    - the issuer has less than 300 holders of record or 500 holders of record where the issuer's total assets have not exceeded $10 million on the last day of each of the preceding three years;
    - the issuer has filed its Section 13(a) reports for the most recent three completed fiscal years, and for the portion of the year immediately preceding the date of filing the Form 15 or the period since the issuer became subject to the reporting obligation; and

30 15 U.S.C. 78m(a).

- a registration statement has not become effective or was required to be updated pursuant to Exchange Act Section 10(a)(3)[31] during the fiscal year.[32]

Because the new statutory threshold for banks and bank holding companies is not reflected in Rule 12g-4, banks and bank holding companies seeking to rely on the new 1,200-holder threshold may not rely on the existing procedural accommodations in the rule. As a result, the statute requires them to wait 90 days after filing a certification with the Commission that the number of holders of record is less than 1,200 persons to terminate their Section 12(g) registration and cease filing reports required by Section 13(a) rather than being able to suspend their Section 13(a) reporting obligations immediately upon the filing of a Form 15 in reliance on the rule. Similarly, banks and bank holding companies are not permitted to rely on Rule 12h-3 to immediately suspend their Section 15(d) reporting obligations using the new higher statutory threshold during a fiscal year. Rather, Section 15(d)(1) provides that they may use the higher thresholds only when seeking to suspend a Section 15(d) obligation on the first day of a fiscal year. Similarly the new statutory threshold also is not reflected in current Rules 12g-2 and 12g-3, leaving all issuers to refer to the lower 300-holder threshold under these rules.

We are proposing to amend these rules to include the JOBS Act thresholds for banks and bank holding companies.[33] The proposed changes would allow banks and

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31 15 U.S.C. 78j(a)(3).

32 The automatic statutory suspension of an issuer's Section 15(d) reporting obligation also is not available as to any fiscal year in which the issuer's Securities Act registration statement becomes effective or is required to be updated pursuant to Section 10(a)(3) of the Securities Act.

33 One commenter expressed support for a change permitting banks and bank holding companies to immediately suspend Section 13(a) reporting at the 1,200-holder threshold upon filing Form 15, as is permitted for all issuers under current rules at the 300-holder threshold. See letter from John Marshall Bank (Apr. 13, 2012).

bank holding companies to rely on the Commission's rules to suspend reporting immediately, to avoid being deemed registered upon the termination of certain exemptions or as a successor issuer, and to terminate their registration during the fiscal year, at the higher 1,200-holder threshold.

B. Increased Thresholds for Savings and Loan Holding Companies' Registration and Reporting Obligations

We are proposing to apply the same thresholds to savings and loan holding companies that apply to banks and bank holding companies. As noted above, banks and bank holding companies under Title VI of the JOBS Act are subject to a higher shareholder registration threshold for a class of equity security under Section 12(g)(1) of the Exchange Act, and a higher threshold for termination of registration under Section 12(g)(4) and for suspension of the duty to file reports under Section 15(d)(1). Section 3(a)(6) of the Exchange Act defines the term "bank";[34] however, neither the Exchange Act nor the Commission's rules define "bank holding company." Section 2 of the Bank Holding Company Act of 1956 specifically excludes "savings and loan holding companies" from the definition of bank holding company.[35] Thus, while banks, savings associations and bank holding companies are covered by Title VI of the JOBS Act, savings and loan holding companies are not.

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[34] 15 U.S.C. 78c(a)(6). Exchange Act Section 3(a)(6) defines a "bank" to include Federal savings associations and any other banking institution or savings association, as defined in the Home Owners' Loan Act. We read this definition to include savings and loan associations and other similar entities.

[35] A savings and loan holding company is a company that controls savings associations or other savings and loan holding companies, similar to the way a bank holding company is a company that controls banks or other bank holding companies. Savings associations and banks are all depository institutions, and each one is regulated by the appropriate Federal banking agency. 12 U.S.C. 1813(q). The definition of "appropriate Federal banking agency" provides which federal banking agency is the primary regulator for the various types of national, state and foreign banks and savings associations.

A commenter representing community banks asserted that savings and loan holding companies should be covered by Title VI of the JOBS Act.[36] Other commenters from the banking industry and Congress have also requested that savings and loan holding companies be treated similarly to bank holding companies for purposes of the registration, termination of registration and suspension of reporting provisions of the Exchange Act.[37] One commenter acknowledged that the JOBS Act did not "expressly extend its new threshold for termination of registration to savings and loan holding companies," but suggested that correction of that omission would be "entirely consistent with the intent and purpose of the JOBS Act."[38]

Based on a review of reporting issuers, we estimate that approximately 125 savings and loan holding companies were reporting issuers as of June 30, 2014, most of which are registered pursuant to Section 12(b).[39] Approximately 90 of these companies reported fewer than 1,200 holders of record and would be eligible to terminate registration under the proposed threshold.[40] These savings and loan holding companies,

36 See letter from Independent Community Bankers of America (Apr. 16, 2012).

37 See, e.g., letters from American Bankers Association (Aug. 10, 2012); Community Bankers Association of Illinois (May 7, 2012); U.S. Representatives Himes and Womack (Nov. 29, 2012); Wayne Savings Community Bank (Apr. 12, 2012); U.S. Representative Stivers (May 4, 2012); and U.S. Representative Gibbs (Dec. 19, 2012).

38 See letter from American Bankers Association.

39 Savings and loan holding companies were identified by examining filings in the relevant Standard Industrial Classification codes.

40 The Board of Governors of the Federal Reserve System (the "Board of Governors") previously determined to exempt commercial savings and loan holding companies from its initial requirement that savings and loan holding companies generally submit the same reports as other banking entities regulated by the Board of Governors. See Agency Information Collection Activities Regarding Savings and Loan Holding Companies: Announcement of Board Approval Under Delegated Authority and Submission to OMB, (Dec. 23, 2011) [76 FR 81933 (Dec. 29, 2011)]. There are six commercial savings and loan holding companies that are all exchange-listed issuers obligated to file, and would continue to be obligated to file, Exchange Act reports pursuant to Exchange Act Section 12(b) (15 U.S.C. 78l(b)). For ease of application and due to the limited effect on, and small number of, such issuers, we are not proposing to differentiate between

however, are subject to regulation by the Board of Governors and are generally required to submit the same reports to banking regulators as other banking entities regulated by the Board of Governors, including banks and bank holding companies covered by Title VI of the JOBS Act.[41]

As noted above, the increased thresholds provided by the JOBS Act for registration, termination of registration and suspension of reporting for banks and bank holding companies do not apply to savings and loan holding companies. This creates inconsistent treatment among depository institutions, resulting in different registration requirements for savings and loan holding companies that otherwise provide services similar to those provided by banks and bank holding companies and are generally subject to similar bank regulatory and supervision requirements. We have received comments in support of treating savings and loan holding companies the same as banks and bank holding companies with regard to the increased thresholds.

We are proposing to revise our rules so that savings and loan holding companies are treated in a similar manner to banks and bank holding companies for the purposes of registration, termination of registration or suspension of their Exchange Act reporting

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commercial saving and loan holding companies and other savings and loan holding companies for purposes of this rulemaking.

41 See id. Title III of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203, 124 Stat. 1376) (the "Dodd-Frank Act") abolished the Office of Thrift Supervision, the regulator that formerly supervised savings and loan holding companies, and transferred its authorities (including rulemaking) related to savings and loan holding companies to the Board of Governors. The Board of Governors assumed supervisory responsibility for savings and loan holding companies and their non-depository subsidiaries beginning on July 21, 2011. The Board of Governors is responsible for the consolidated supervision of bank holding companies and savings and loan holding companies and requires those entities to provide data relating to capitalization, liquidity, and risk management as well as periodic financial reports in order for the Board of Governors to analyze the overall financial condition of those entities to ensure safe and sound operations. These reports include, among others, quarterly Consolidated Financial Statements for Bank Holding Companies (FR Y-9C) and an Annual Report of Bank Holding Companies (FR Y-6).

obligations. Unlike for bank holding companies, which are able to rely on the JOBS Act statutory changes, the revised rules would be the sole basis on which savings and loan holding companies could rely when making those determinations. We are proposing to apply the new higher thresholds applicable to banks and bank holding companies to savings and loan holding companies[42] because we believe the regulatory oversight applicable to savings and loan holding companies is substantially similar to the regulatory oversight for bank holding companies. We believe these companies should be treated consistently with other depository institutions under our rules. We are therefore proposing to amend Exchange Act Rule 12g-1 to establish an exemption for savings and loan holding companies from the registration requirement that mirrors the exemption for banks and bank holding companies established by the JOBS Act. In addition, we are proposing to revise Exchange Act Rules 12g-2, 12g-3, 12g-4 and 12h-3 to permit savings and loan holding companies to immediately suspend current and periodic reporting upon filing Form 15 at the 1,200-holder threshold in the same manner as banks and bank holding companies.

C. Application of the Increased Threshold for Accredited Investors

Section 501 of the JOBS Act amended Exchange Act Section 12(g)(1) to increase the threshold that triggers registration by an issuer other than a bank or bank holding company to total assets exceeding $10 million and a class of equity security (other than an exempted security) held of record by either 2,000 persons or 500 persons who are not accredited investors (as such term is defined by the Commission).[43] A number of

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42 Under our proposal "savings and loan holding company" would be defined pursuant to Section 10 of the Home Owners' Loan Act. 12 U.S.C. 1461.

43 The statutory amendment was effective upon enactment of the JOBS Act and does not require any Commission action. While this change primarily affects issuers that have never had a reporting

commenters pointed to potential compliance concerns with respect to identifying accredited investors and recommended ways to facilitate issuers' use of the increased threshold for holders of record that are accredited investors. Some commenters recommended that the Commission confirm that the term "accredited investor" as used in this provision of the JOBS Act has the same meaning as set forth in Securities Act Rule 501(a)[44] of Regulation D.[45] One commenter further recommended that the Commission permit an issuer to rely on an annual affirmation from investors that their accredited investor status has not changed.[46] Other commenters recommended that the Commission provide guidance or a safe harbor to allow issuers to rely on an ongoing basis on information previously obtained about a shareholder's accredited investor status.[47] Commenters also recommended that the Commission provide additional flexibility by, for example, permitting issuers to rely on the determinations made by certain third

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obligation under the Exchange Act, issuers that have filed a Securities Act registration statement that became effective but have not triggered an Exchange Act Section 12(g) registration requirement and issuers that have terminated registration or suspended their reporting obligation will need to monitor the accredited investor status of their investors as of the last day of each fiscal year.

44 17 CFR 230.501(a).

45 See letters from New York City Bar Association (June 6, 2012) ("NYCBA") and the Business Law Section of the American Bar Association (June 26, 2013) ("ABA"). The ABA letter further requested that the Commission provide guidance on the type of information upon which issuers may rely and specifically recommended that the Commission not require issuers to take reasonable steps to verify accredited investor status.

46 See letter from ABA.

47 See letters from Foley & Lardner (May 24, 2012) and NYCBA. Foley & Lardner recommended allowing reliance on information obtained at the time the issuer's securities were initially issued, or, in the alternative, when the securities were most recently issued, when making the determination of whether the holders are accredited for purposes of counting holders under Section 12(g). NYCBA recommended that the Commission expressly permit an issuer "to rely on any determination of 'accredited investor' status made in connection with the issuer's most recent sale of securities to the relevant investor, or the most recent transfer to the investor in connection with which the issuer actually determined that the investor was 'accredited.'" Other commenters also supported permitting issuers to rely on information previously provided if an investor fails to provide the issuer with updated information. See letters from ABA and Keith Paul Bishop (June 13, 2012).

parties, such as financial intermediaries, or permitting determinations during a reasonable period before or after the fiscal year end.[48]

To rely on the new, higher threshold established by the JOBS Act, an issuer will need to be able to determine which of its record holders are accredited investors. We are not proposing to establish a new definition of "accredited investor" for the purposes of Section 12(g)(1). Securities Act Rule 501(a) contains a definition of "accredited investor" that includes any person who comes within, or who the issuer reasonably believes comes within, any of eight enumerated categories.[49] Section 413(b) of the Dodd-Frank Act specifically requires the Commission to undertake a review of the "accredited investor" definition in its entirety, as it relates to natural persons, every four years and no earlier than July 10, 2014.[50]

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48 See letter from ABA. ABA suggested that the rule should provide some flexibility on the timing of the determination. This would permit issuers to rely on information available to them at the time they made a judgment regarding accredited investor status, rather than requiring issuers to update the information as of the end of the fiscal year. See also letter from NYCBA recommending that the Commission adopt rules open to the possibility that limited access trading venues may be able to treat all participants as accredited investors. One commenter recommended that the Commission require issuers to determine accredited investor status as of the last day of each fiscal year. See letter from Keith Paul Bishop.

49 Under Securities Act Rule 501(a) the categories of accredited investor include: a bank, insurance company, registered investment company, business development company, or small business investment company; an employee benefit plan (within the meaning of the Employee Retirement Income Security Act) if a bank, insurance company, or registered investment adviser makes the investment decisions, or if the plan has total assets in excess of $5 million; a tax exempt charitable organization, corporation or partnership with assets in excess of $5 million; a director, executive officer, or general partner of the company selling the securities; an enterprise in which all the equity owners are accredited investors; an individual with a net worth of at least $1 million, not including the value of his or her primary residence; an individual with income exceeding $200,000 in each of the two most recent calendar years or joint income with a spouse exceeding $300,000 for those years and a reasonable expectation of the same income level in the current year; and a trust with assets of at least $5 million, not formed only to acquire the securities offered, and whose purchases are directed by a person who meets the legal standard of having sufficient knowledge and experience in financial and business matters to be capable of evaluating the merits and risks of the prospective investment.

50 We have already requested comment on this definition. See Amendments to Regulation D, Form D and Rule 156, Release No. 33-9416 (Jul. 10, 2013) [78 FR 44806 (Jul. 24, 2013)].

We are proposing that the definition of "accredited investor" in Securities Act Rule 501(a) apply in making determinations under Exchange Act Section 12(g)(1).[51] The "accredited investor" determination would be made as of the last day of the fiscal year rather than at the time of the sale of the securities.[52] Issuers conducting offerings in reliance on an exemption from Securities Act registration in which purchasers must be accredited investors typically take appropriate steps to establish a reasonable belief that a prospective investor is an accredited investor. This reasonable belief is based on an issuer's due diligence and depends on the particular facts and circumstances surrounding the determination. We believe applying the familiar concepts of the accredited investor definition in Rule 501(a) to the registration threshold in Section 12(g)(1) would facilitate compliance for issuers.

After an issuer completes its offering and has sold securities to purchasers who have been determined to be accredited investors, it is not required to periodically assess an investor's continued status as an accredited investor. We recognize that issuers may have difficulty determining whether existing security holders are accredited investors for purposes of the threshold in Section 12(g)(1) and that providing a safe harbor or other guidance could help to mitigate costs for issuers seeking to determine accredited investor status. Some commenters have suggested that we permit issuers to rely on information previously provided by these security holders in connection with the purchase or transfer

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51 Although the term "accredited investor" is also defined in Securities Act Rule 215 [17 CFR 230.215] for the purpose of the statutory exemption from registration under Section 4(a)(5) [15 U.S.C. 78d(a)(5)], the definition of "accredited investor" contained in Securities Act Rule 501(a) of Regulation D is the more commonly understood meaning of the term, given the prevalence of the use of Regulation D for exempt offerings.

52 Securities Act Rule 501(a) otherwise defines "accredited investor" as being determined at the time of the sale of the securities.

of securities for an indefinite period into the future.[53] We believe such reliance could, however, result in the use of outdated information that may no longer be reliable. Instead, an issuer will need to determine, based on facts and circumstances, whether it can rely upon prior information to form a reasonable basis for believing that the security holder continues to be an accredited investor as of the last day of the fiscal year.

Without new guidance from the Commission, when making the determination at fiscal year-end of whether a security holder is an accredited investor for purposes of Exchange Act Section 12(g)(1), issuers would likely use procedures similar to those used when relying on Rule 506.[54] We recognize that the accredited investor determination under the Securities Act is made in the context of an investor making an investment decision, while in the Exchange Act context it is made when an issuer is considering whether it must register a class of securities with the Commission. In light of this, we are considering whether a different approach would be appropriate for determining accredited investor status under Section 12(g) and solicit comment on the appropriate structure and criteria for such an approach below.

Request for Comment

1. We are proposing to revise Rule 12g-1 to reflect changes made by Titles V and VI of the JOBS Act. Should we include the requirements of Section 12(g)(1) in our rules as proposed? Should we delete the provision in the current Rule 12g-1 that precludes

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53 See supra note 47.

54 The procedures used in a Rule 506 offering may vary depending on a number of factors, including the nature of the purchaser and whether the offering is pursuant to Rule 506(b) or Rule 506(c). Rule 506(c) requires an issuer to take reasonable steps to verify that purchasers of securities sold in such offering are accredited investors. As we previously recognized when we adopted Rule 506(c), "issuers may have to apply a stricter and more costly process to determine accredited investor status than what they currently use." See Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings, Release No. 33-9415 (Jul. 10, 2013) [78 FR 44771 (Jul. 24, 2013)].

foreign private issuers from relying on the exemption from registration if their securities are quoted on an automated inter-dealer quotation system, as proposed?

2. The higher registration and reporting thresholds could result in issuers having a significant number of shareholders with freely tradable shares who lack current disclosure information about the issuer. How would investors get the information they need in connection with purchases and sales? What investor protection issues are raised when these security holders engage in secondary market transactions and how might they be addressed?

3. Should we extend the new registration, termination of registration and suspension of reporting thresholds for banks and bank holding companies to savings and loan holding companies, as proposed? We are proposing to use the definition of "savings and loan holding company" as defined in Section 10 of the Home Owners' Loan Act. Does the proposed definition cover the appropriate entities? If not, what definition should be used?

4. We are proposing to permit savings and loan holding companies to use the higher thresholds equivalent to those available to banks and bank holding companies. Are there facts and circumstances, other than those discussed above, that we should consider in evaluating whether to provide those higher thresholds? How would using different thresholds for savings and loan holding companies impact market participants and investors? What effect would different thresholds have on competition between savings and loan holding companies and other depository institutions, such as banks and bank holding companies?

5. The population of savings and loan holding companies includes commercial savings and loan holding companies that the Board of Governors exempted from its

initial requirement that savings and loan holding companies generally submit the same reports as other banking entities regulated by the Board of Governors.[55] These commercial savings and loan holding companies are all exchange-listed issuers that are currently registered and required to file reports under Section 12(b) of the Exchange Act. Should these companies be permitted to rely on the higher thresholds applicable to banks and bank holding companies? Should we instead carve out such savings and loan holding companies or provide other limitations for these companies?

6. Some commenters have recommended that we provide a safe harbor or other guidance to provide issuers with more certainty on how to establish a reasonable belief that a security holder is an accredited investor and therefore qualifies under the definition. Are there circumstances in the determination required to be made under Section 12(g) that suggest the need for a safe harbor or guidance, and if so, is one preferable over the other? What should be the parameters of any safe harbor or guidance? Should a safe harbor or other guidance specify the methods of inquiry an issuer could make or the documents it should obtain that would establish a reasonable belief? What methods or standards should we adopt and what steps should we require in making the determination? What negative effects on investors, if any, could result from providing a safe harbor or other guidance? Absent a safe harbor or other guidance, what burdens would the issuer face in establishing reasonable belief that a security holder is an accredited investor and in making the determination as to whether it has exceeded the Section 12(g) thresholds for Exchange Act reporting? Please quantify, if possible, the

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[55] See supra note 40.

expected costs of establishing a reasonable belief every year for each accredited investor and compare the expected costs to the estimated costs of registration.

7. If the rules were to include a safe harbor or other guidance, should we permit an issuer to form its reasonable belief that a person is an accredited investor based on determinations made by specified third parties? For example, in Securities Act Rule 506(c)(2)(ii)(C) we allow issuers to rely on a written confirmation by a registered broker-dealer, a registered investment adviser, a licensed attorney, or a certified public accountant to satisfy the requirement that the issuer take reasonable steps to verify the accredited investor status of a purchaser. Should a similar written confirmation be sufficient here? Should we permit written confirmations from other third parties not subject to regulatory oversight? Why or why not? If we permit written confirmations from third parties that are not subject to regulatory oversight such as those found in Rule 506(c)(2)(ii)(C), should we require issuers to perform some level of due diligence on the accredited investor determinations made by those third parties or on the third parties making those determinations? Would the answer depend on the nature of the third party? Alternatively, should we permit an issuer to rely on a written certification by the investor, on other specified information obtained by the issuer, or on a combination of a certification and other information? What information, other than a written investor certification, would it be appropriate to require? Would the answer depend on whether an issuer had determined at the time of the initial investment that the investor was an accredited investor? For what period of time should that determination be considered reliable? Should the safe harbor or other guidance specify that determinations made a specified period before or after the fiscal year end would be deemed to be reasonable? If

so, what would be a reasonable time period for making such determination? What documentation, if any, should be retained by the issuer?

8. For purposes of any safe harbor or other guidance, should we permit an issuer to rely on previously obtained information relating to the person's accredited investor status, such as information obtained at the time the issuer's securities were initially, or most recently, sold to that person? Should such a provision be limited to situations in which the issuer does not have information that would lead it to believe that the previously obtained information was incorrect, unreliable or had changed? Should we place a time limit on the permitted use of previously obtained information, such as only permitting the use of information received within the preceding six months or year? Should an issuer be able to rely on information previously obtained if the security holder failed to respond to an issuer's request for an annual affirmation of accredited investor status?

III. PROPOSED AMENDMENTS TO EXCHANGE ACT RULE 12g5-1

A. Statutory Requirement and Definition of "Employee Compensation Plan"

Exchange Act Section 12(g)(5), as amended by Section 502 of the JOBS Act, provides that the definition of "held of record" shall not include securities held by persons who received them pursuant to an "employee compensation plan" in transactions exempted from the registration requirements of Section 5 of the Securities Act. By its express terms, this new statutory exclusion applies solely for purposes of determining whether an issuer is required to register a class of equity securities under the Exchange Act and does not apply to a determination of whether such registration may be terminated or suspended.[56] The provision, which is substantially broader than the Commission's current rules exempting compensatory employee stock options from Section 12(g) registration,[57] does not define the term "employee compensation plan."

Section 503 of the JOBS Act instructs the Commission to amend the definition of "held of record" to implement the amendment in Section 502 and to adopt a safe harbor that issuers can use when determining whether holders of their securities received them pursuant to an employee compensation plan in exempt transactions. We are proposing to amend Exchange Act Rule 12g5-1 to implement the statutory exclusion created by Section 502 of the JOBS Act and to establish a non-exclusive safe harbor for issuers as directed by Section 503.[58]

Subsequent to the adoption of the JOBS Act, a number of commenters provided recommendations to the Commission as to how "employee compensation plan" should be defined. Some commenters recommended that the Commission interpret the term broadly to promote the use of employee equity issuances.[59] One commenter indicated that "linking the scope of Rule 701 and amended Section 12(g)(5) makes sense, in light

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56 The statutory exclusion in Section 12(g)(5) specifically refers to Exchange Act Section 12(g)(1), which relates to when an issuer must register its securities with the Commission.

57 Exchange Act Rule 12h-1(f) [17 CFR 240.12h-1(f)] provides non-reporting issuers with an exemption from Section 12(g) registration for stock options issued under written compensatory stock option plans under certain conditions. Exchange Act Rule 12h-1(g) [17 CFR 240.12h-1(g)] provides a similar exemption for stock options for reporting issuers that are required to file such periodic reports. The exemptions provide specific eligibility requirements and are limited to options issued pursuant to a written compensatory stock option plan. See Exemption of Compensatory Stock Options from Registration Under Section 12(g) of the Securities Exchange Act of 1934, Release No. 34-56887 (Dec. 3, 2007) [72 FR 69554 (Dec. 7, 2007)] (the "Compensatory Stock Options Release").

58 See Proposed Rule 12g5-1(a)(7).

59 See letter from Foley & Lardner recommending a broad definition of "employee compensation plan" that would include arrangements that are not written. See also letter from Keith Paul Bishop recommending a broad definition of "employee compensation plan."

of the apparent purpose of the latter provisions, and will avoid needless complexity."[60] Another commenter recommended that the Commission establish a non-exclusive safe harbor without recommending a specific definition for "employee compensation plan."[61] This commenter suggested that "application in a Section 12(g) context of the familiar concepts applied in connection with the exempt issuance of compensatory equity securities under Rule 701 will facilitate compliance by streamlining a smaller issuer's learning curve and simplifying recordkeeping."[62] In addition, this commenter specifically recommended that the safe harbor "explicitly import the interpretation of Rule 701(c)" in order to incorporate "the full range of compensatory arrangements and security holders described in Rule 701(c) under the Securities Act" and that it "should cover equity securities in the hands of the full range of participants and permitted transferees enumerated in Rule 701(c)."[63] This commenter also indicated that "the requirement of a written arrangement is reasonable in the Section 12(g)(5) context, as well as for Rule 701."[64] Commenters also made specific recommendations regarding additional securities that should be considered "securities received pursuant to an employee compensation plan."[65]

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60 See letter from NYCBA. For a more detailed explanation of Securities Act Rule 701, see infra notes 66 and 72.

61 See letter from ABA. ABA indicated that "it is important that the concept of 'employee compensation plan' encompass both traditional plans and individual compensatory agreements and include compensatory arrangements established by the various entities related to the issuer enumerated in Rule 701(c)."

62 See id.

63 See id.

64 See id., indicating that state corporate law generally requires some documentation of authorized issuances of equity securities. This recommendation contrasts with recommendations of other commenters suggesting that the term "employee compensation plan" should not be read to require a written arrangement. See supra note 59.

65 See, e.g., letter from David C. Fisher (June 13, 2012), recommending that "securities acquired in an issuer-sponsored internal market, limited to transactions in securities received pursuant to the

Instead of creating a new definition for the term "employee compensation plan," we are proposing to revise the definition of "held of record" and establish a non-exclusive safe harbor that relies on the current definition of "compensatory benefit plan" in Rule 701 and the conditions in Rule 701(c).[66] Although some commenters recommended that we create a new, broad definition, we believe that by not defining the term "employee compensation plan," and by providing for a non-exclusive safe harbor, we are providing issuers with flexibility in their determination under Section 12(g)(5). We concur with some commenters who recommended applying the Rule 701 concepts that issuers already employ for exempt issuances, and propose to use those concepts as part of the non-exclusive safe harbor. We further believe that developing a new definition for "employee compensation plan" at this time potentially could result in needless complexity and create conflicts with the current definitions of "compensatory benefit plan" and "employee benefit plan," which the Commission has sought to harmonize.[67]

By conditioning the new exclusion from "held of record" upon the securities being received pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the Securities Act, Section 502 of the JOBS Act uses Securities Act concepts to identify persons that an issuer may exclude

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issuer's employee compensation plans, will be considered securities received pursuant to an employee compensation plan." See also letter from NYCBA suggesting that "'closed system' platforms and trading venues" may be able to afford issuers a reasonable basis to determine that participants are excludable employees.

66 In 1988, the Commission adopted Securities Act Rule 701 [17 CFR 230.701] to provide an exemption from Securities Act registration for offers and sales of securities made pursuant to compensatory benefit plans by issuers that are not subject to the reporting requirements of Section 13 or 15(d) of the Exchange Act. See Compensatory Benefit Plans and Contracts, Release No. 33-6768 (Apr. 14, 1988) [53 FR 12918 (Apr. 20, 1988)] (the "Rule 701 Adopting Release").

67 See Rule 701 – Exempt Offerings Pursuant to Compensatory Arrangements, Release No. 33-7645 (Feb. 25, 1999) [64 FR 11095 (Mar. 8, 1999)] (the "1999 Rule 701 Release"), and Registration of Securities on Form S-8, Release No. 33-7646 (Feb. 25, 1999) [64 FR 11103 (Mar. 8, 1999)] (the "1999 Form S-8 Release").

from its determination of the number of holders of record under Section 12(g)(1) of the Exchange Act. Given this express interaction between Securities Act and Exchange Act concepts in this provision of the JOBS Act, we believe that it would facilitate compliance if the terminology we use in proposed Exchange Act Rule 12g5-1(a)(7) is consistent with the terminology used in our Securities Act rules.

In regulating securities offerings to employees, we use the term "employee benefit plan," as defined in Securities Act Rule 405,[68] for Securities Act Form S-8 registration,[69] but use the term "compensatory benefit plan" in the Securities Act Rule 701 exemption. A "compensatory benefit plan" under Rule 701(c)(2) is broadly defined as "any purchase, savings, option, bonus, stock appreciation, profit sharing, thrift, incentive, deferred compensation, pension or similar plan."[70] When adopting Rule 701, the Commission expressly stated that it patterned the definition of "compensatory benefit plan" on the definition used in Securities Act Rule 405.[71] Rule 701 includes a number of conditions consistent with the Rule 405 definition of "employee benefit plan." In particular, Rule 701(c) limits the exemption to offers and sales of securities under a written compensatory

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68 Securities Act Rule 405 defines an "employee benefit plan" as any written purchase, savings, option, bonus, appreciation, profit sharing, thrift, incentive, pension or similar plan or written compensation contract solely for employees, directors, general partners, trustees (where the registrant is a business trust), officers, or consultants or advisors. However, consultants or advisors may participate in an employee benefit plan only if: (1) They are natural persons; (2) They provide bona fide services to the registrant; and (3) The services are not in connection with the offer or sale of securities in a capital-raising transaction, and do not directly or indirectly promote or maintain a market for the registrant's securities.

69 The Commission permits issuers that are subject to Exchange Act reporting requirements to register the offer and sale of securities to employees pursuant to employee benefit plans on Form S-8. This form provides for abbreviated disclosure and automatic effectiveness upon filing. See Adoption of Form S-8, Release No. 33-3480 (June 16, 1953) [18 FR 3688 (June 27, 1953)]. See also Registration and Reporting Requirements for Employee Benefit Plans, Release No. 33-6867 (June 6, 1990) [55 FR 23909 (June 13, 1990)] (the "1990 Form S-8 Release")

70 17 CFR 230.701(c)(2).

71 See the Rule 701 Adopting Release.

benefit plan established by the issuer for the participation of its employees and other specified persons.[72] Many of the conditions applicable to exempt offers and sales made under Rule 701 are also similar to conditions placed on Form S-8 registration of securities to be offered under an "employee benefit plan" as defined in Rule 405. For example, Rule 701(c)(3) defines eligible family members consistent with Form S-8.[73] In addition, the Rule 701 exemption includes a number of conditions to its use, including but not limited to conditions that the plan be written and delivered to employees; that the plan be established by the issuer, its parents, its majority-owned subsidiaries or majority-owned subsidiaries of the issuer's parent, for the participation of their employees,

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72 Securities Act Rule 701(c) exempts offers and sales of securities (including plan interests and guarantees pursuant to paragraph (d)(2)(ii)) under a written compensatory benefit plan (or written compensation contract) established by the issuer, its parents, its majority-owned subsidiaries or majority-owned subsidiaries of the issuer's parent, for the participation of their employees, directors, general partners, trustees (where the issuer is a business trust), officers, or consultants and advisors, and their family members who acquire such securities from such persons through gifts or domestic relations orders. This section exempts offers and sales to former employees, directors, general partners, trustees, officers, consultants and advisors only if such persons were employed by or providing services to the issuer at the time the securities were offered. In addition, the term "employee" includes insurance agents who are exclusive agents of the issuer, its subsidiaries or parents, or who derive more than 50% of their annual income from those entities. As explained in the 1999 Rule 701 Release at Section II.D, Rule 701 is also available to persons with a de facto employment relationship with the issuer. Such a relationship would exist where a person not employed by the issuer provides the issuer services that traditionally are performed by an employee and the compensation paid for those services is the primary source of the person's earned income.

73 Form S-8 and Rule 701 are available for the exercise of employee benefit plan options by an employee's family member who has acquired the options from the employee through a gift or a domestic relations order. See the 1999 Form S-8 Release at Section III and the 1999 Rule 701 Release at Section II.E. As defined in Exchange Act Rule 701(c)(3) [17 CFR 230.701(c)(3)], for this purpose, "family member" includes any child, stepchild, grandchild, parent, stepparent, grandparent, spouse, former spouse, sibling, niece, nephew, mother-in-law, father-in-law, son-in-law, daughter-in-law, brother-in-law, or sister-in-law, including adoptive relationships, any person sharing the employee's household (other than a tenant or employee), a trust in which these persons have more than 50% of the beneficial interest, a foundation in which these persons (or the employee) control the management of assets, and any other entity in which these persons (or the employee) own more than 50% of the voting interests.

directors, general partners, trustees, officers, or consultants and advisors;[74] and that the amount of securities sold be limited.

B. Definition of "Held of Record" and Non-exclusive Safe Harbor for Determining Holders of Record

As directed by Section 503 of the JOBS Act, the Commission is proposing to amend the definition of "held of record" and to establish a safe harbor in Rule 12g5-1 that issuers can rely on when determining if securities held by persons who received them pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the Securities Act may be excluded when calculating the number of holders of record of a class of equity securities for purposes of determining the issuer's registration obligation under Section 12(g)(1)(A).[75] We received comments addressing issues about the scope of the safe harbor. One commenter recommended that the Commission expressly provide that the safe harbor is a non-exclusive safe harbor akin to the Securities Act Rule 506 safe harbor under Securities Act Section 4(a)(2).[76] This commenter also recommended that a safe harbor should provide that in a "subsequent transaction (including a business combination) that is exempt from,

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74 The Commission adopted amendments to Form S-8 and the Rule 405 definition of "employee benefit plan" that made Form S-8 available for the issuance of securities to consultants or advisors only if: they are natural persons; they provide bona fide services to the registrant; and the services are not in connection with the offer or sale of securities in a capital-raising transaction, and do not directly or indirectly promote or maintain a market for the registrant's securities. See 1999 Form S-8 Release and 1999 Rule 701 Release. Rule 701(c)(1) applies the same limitations regarding consultants and advisors as those provided in Form S-8 and the Rule 405 definition of "employee benefit plan."

75 As proposed, this amendment would not affect the definition of "held of record" when determining the number of holders for the purposes of termination of registration or suspension of reporting or with regard to the number of holders reported pursuant to Item 201(b) of Regulation S-K (17 CFR 229.201(b)).

76 See letter from ABA recommending that the Commission provide "that the safe harbor(s) is not the exclusive means by which an issuer may comply with the 'compensatory plan carve-out' provisions of Section 12(g)(5)." This commenter suggested that "failure to satisfy all conditions to reliance on the safe harbor(s) should not preclude reliance on the statutory carve-out itself."

or otherwise is not subject to, the registration requirements of Section 5, the securities issued in that transaction to eligible employees, former employees, and other covered persons in exchange for securities covered by the Section 12(g)(5) compensatory plan securities carve out" would also be covered.[77] The same commenter further recommended that securities issued in unregistered transactions based on the "no sale" theory should be included within the definition of "transactions exempt from section 5."[78]

1. Definition of "Held of Record"

We are proposing to amend the definition of "held of record" to provide that when determining whether an issuer is required to register a class of equity securities with the Commission pursuant to Exchange Act Section 12(g)(1) an issuer may exclude securities that are either:

- held by persons who received the securities pursuant to an employee compensation plan in transactions exempt from the registration requirements of Section 5 of the Securities Act or that did not involve a sale within the meaning of Section 2(a)(3) of the Securities Act; or
- held by persons eligible to receive securities from the issuer pursuant to Exchange Act Rule 701(c) who received the securities in a transaction exempt from the

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77 See id.

78 See id. The "no sale" theory relates to the issuance of compensatory grants made by employers to broad groups of employees pursuant to broad-based stock bonus plans under the theory that the awards are not an offer or sale of securities under Section 2(a)(3) of the Securities Act [15 U.S.C. 77b(a)(3)]. See Employee Benefit Plans; Interpretations of Statute, Release No. 33-6188 (Feb. 1, 1980) [45 FR 8960 (Feb. 11, 1980)] at Section II.A.5.d; Employee Benefit Plans, Release No. 33-6281 (Jan. 15, 1981) [46 FR 8446 (Jan. 27, 1981)] at Section III. Many issuers rely on the "no sale" theory when making such awards to employees where no consideration – and hence no "value" – is received by the issuer in return. The staff has not objected to these issuances in a series of no-action letters. See, e.g., no-action letter to Verint Systems Inc. (May 24, 2007).

registration requirements of Section 5 of the Securities Act in exchange for securities excludable under proposed Rule 12g5-1(a)(7).

Section 502 of the JOBS Act refers specifically to "transactions exempted" from the Securities Act Section 5 registration requirements. A number of issuers, however, issue securities to employees without Securities Act registration on the basis that the issuance is not a sale under Section 2(a)(3) of the Securities Act and therefore do not trigger the registration requirement of Securities Act Section 5, which applies only to the offer and sale of securities. While securities issued to employees in transactions that do not involve a sale under Section 2(a)(3) are not technically "transactions exempted from the registration requirements of section 5," they are similar to other compensatory issuances to employees in exempt transactions in that the issuer provides the awards to employees for a compensatory purpose. We are therefore proposing to exclude such "no sale" issuances from the definition of "held of record" in Rule 12g5-1 for purposes of determining an issuer's obligation to register a class of securities under the Exchange Act.

As proposed, the rule would also permit an issuer to exclude holders who are persons eligible to receive securities from the issuer pursuant to Rule 701(c) and who acquired the securities in exchange for securities excludable under the proposed definition.[79] The proposed exclusion is intended to facilitate the ability of an issuer to conduct restructurings, business combinations and similar transactions that are exempt from Securities Act registration so that if the securities being surrendered in such a transaction would not have been counted under the proposed definition of "held of

79 See supra note 72 and 73 and infra note 82 (describing the types of persons eligible to receive securities under Rule 701(c)).

record," the securities issued in the exchange also would not be counted under this definition.[80] The securities issued in the exchange would be deemed to have a compensatory purpose because they would replace other securities previously issued pursuant to an employee compensation plan. We believe such an approach would be consistent with the intent of Section 502 of the JOBS Act and would provide issuers with appropriate flexibility to conduct certain business combinations and similar transactions.

2. Non-exclusive Safe Harbor for Determining Holders of Record

We are proposing a non-exclusive safe harbor under proposed Rule 12g5-1(a)(7) that would provide that a person will be deemed to have received the securities pursuant to an employee compensation plan if such person received them pursuant to a compensatory benefit plan in transactions that met the conditions of Securities Act Rule 701(c).[81]

As proposed, an issuer would be able to rely on the safe harbor for determining the holders of securities issued in reliance on Securities Act Rule 701, as well as holders of securities issued in transactions otherwise exempted from, or not subject to, the registration requirements of the Securities Act that satisfy the conditions of Rule 701(c), even if all the other conditions of Rule 701, such as issuer eligibility in Rule 701(b)(1), the volume limitations in Rule 701(d) or the disclosure delivery provisions in Rule 701(e), were not met. Thus, the safe harbor would be available for holders of securities received in other employee compensation plan transactions exempted from, or not subject

80 Consistent with Rule 701(c), securities held of record by former employees would be excluded when determining the securities held of record only if the employees were employed by or providing services to the surviving issuer at the time the exchange securities were offered.

81 As proposed, failure to satisfy all of the conditions of the non-exclusive safe harbor would not preclude reliance on Section 12(g)(5) or other provisions of proposed Rule 12g5-1(a)(7).

to, the registration requirements of Section 5 of the Securities Act, such as securities issued in reliance on Securities Act Section 4(a)(2), Regulation D of the Securities Act, or Regulation S of the Securities Act, that meet the conditions of Rule 701(c).

We believe that using the conditions of Rule 701(c) to structure the safe harbor for determining whether holders received their securities pursuant to an employee compensation plan in exempt transactions would allow issuers to apply well understood principles of an existing Securities Act exemption to the new Exchange Act registration determination under the JOBS Act. The safe harbor would be available for the plan participants enumerated in Rule 701(c), including employees, directors, general partners, trustees, officers and certain consultants and advisors.[82] The safe harbor also would be available for permitted family member transferees with respect to securities acquired by gift or domestic relations order, or securities acquired by them in connection with options transferred to them by the plan participant through gifts or domestic relations orders.[83] Because the safe harbor would be limited to holders who are persons specified in Rule 701(c) who received the securities under specified circumstances, once these persons

[82] A de facto employee would be considered an employee for purposes of proposed Rule 12g5-1(a)(7). For purposes of Rule 701, the scope of eligible consultants and advisors is the same as under Form S-8. See 1999 Rule 701 Release at Section II.D and 1999 Form S-8 Release at Section II.A.1. This also would be the case for purposes of proposed Rule 12g5-1(a)(7). We note that unlike traditional employees, consultants and advisors typically provide their services to multiple clients rather than to the same issuer on a dedicated basis. This distinction may cause them to be less likely to hold the securities they receive as compensation and more likely to sell them. However, the fact that securities would no longer be eligible for the exclusion under the safe harbor following their transfer should limit the potential for abuse. We believe that in light of the Rule 701 restrictions applicable to consultants and advisors, the compensatory nature of the transactions justifies treating consultants and advisors who are eligible to receive securities in compensatory transactions that satisfy the conditions of Rule 701(c) as persons who receive securities pursuant to an employee compensation plan for purposes of the proposed safe harbor.

[83] See Rule 701- Exempt Offerings Pursuant to Compensatory Arrangements, Release No. 33-7511 (Feb. 27, 1998) [63 FR 10785 (Mar. 5, 1998)] at Section III.E.4. Including family member transferees in the safe harbor would be consistent with the approach in Rule 701(c), which provides an exemption to family member transferees in connection with stock options because of their common economic interest and the non-capital raising nature of the transactions.

subsequently transfer the securities, whether or not for value, the securities would need to be counted as held of record by the transferee for purposes of determining whether the issuer is subject to the registration and reporting requirements of Exchange Act Section 12(g)(1).

In addition, under the proposed rules, foreign private issuers[84] would be able to rely on the safe harbor when making their determination of the number of U.S. resident holders under Exchange Act Rule 12g3-2(a).[85] Under Rule 12g3-2(a), foreign private issuers that meet the asset and shareholder threshold of Section 12(g) are exempt from registering any class of securities under that section if the class of securities is held by fewer than 300 holders resident in the United States. For purposes of determining whether this threshold is met, Rule 12g3-2(a)(1) specifies that the method shall be as provided in Exchange Act Rule 12g5-1, subject to specific provisions relating to brokers, dealers, banks and nominees.[86] Because the rule directs issuers to the definition of "held of record" in Rule 12g5-1, the statutory changes to Section 12(g)(5) as well as the

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84 The definition of "foreign private issuer" is contained in Exchange Act Rule 3b-4(c) [17 CFR 240.3b-4(c)]. A foreign private issuer is any foreign issuer other than a foreign government, except for an issuer that (1) has more than 50% of its outstanding voting securities held of record by U.S. residents and (2) any of the following: (i) a majority of its officers and directors are citizens or residents of the United States; (ii) more than 50% of its assets are located in the United States; or (iii) its business is principally administered in the United States.

85 17 CFR 240.12g3-2(a)

86 The proposed amendment to Rule 12g5-1 would be limited to determinations under Section 12(g). The definition of "foreign private issuer" in Exchange Act Rule 3b-4 contains a cross-reference to Rule 12g3-2(a) for purposes of calculating record ownership in determining whether more than 50% of an issuer's outstanding voting securities are directly or indirectly held by residents of the United States. In contrast to the proposed approach to Rule 12g3-2(a), we are proposing to amend Rule 3b-4 to clarify that securities held by employees must continue to be counted for the purpose of determining the percentage of the issuer's outstanding securities held by U.S. residents, and thus for determining whether an issuer qualifies as a foreign private issuer. See the proposed amended instruction to paragraph (c)(1) of Rule 3b-4.

proposed changes to Rule 12g5-1 would also apply to the determination of a foreign private issuer's U.S. resident holders for the purposes of the Rule 12g3-2(a) analysis.[87]

Request for Comment

9. Instead of leaving the term "employee compensation plan" undefined and providing a safe harbor for purposes of determining the number of holders of record under Section 12(g)(1), should we create a new definition for purposes of the determination? If a new definition would be preferable, please describe how "employee compensation plan" should be defined and explain why a definition would be preferable.

10. In some circumstances issuers may rely on a "no sale" theory under Section 2(a)(3) of the Securities Act to issue securities to employees. As proposed, securities held by persons who received those securities pursuant to an award to employees that did not involve a sale within the meaning of Securities Act Section 2(a)(3) would be excluded from the definition of "held of record" for purposes of determining an issuer's Exchange Act Section 12(g) registration obligations. Should these securities be excluded from the definition?

11. The exclusion from "held of record" in proposed Exchange Act Rule 12g5-1(a)(7)(i) for securities received pursuant to employee compensation plans would include within its scope holders of securities received pursuant to an employee compensation

87 The definition of "foreign private issuer" under the Securities Act, which is found in Securities Act Rule 405 [17 CFR 230.405], is the same as the definition under Exchange Act Rule 3b-4. The definition of "foreign private issuer" under the Securities Act was last amended in Foreign Issuer Reporting Enhancements, Release No. 33-8959 (Sept. 23, 2008) [73 FR 58300 (Oct. 6, 2008)]. At that time, an instruction to paragraph (1) of the definition, which was the same as the Instruction to Paragraph (c)(1) of Rule 3b-4, was inadvertently omitted. We are proposing to amend the foreign private issuer definition under Rule 405 to reinsert the omitted instruction but with a proposed revision, identical to that proposed under Rule 3b-4, clarifying that securities held by employees must continue to be counted for the purposes of determining the percentage of the issuer's outstanding securities held by U.S. residents and foreign private issuer status under the Securities Act.

plan in transactions that do not involve a sale within the meaning of Section 2(a)(3) or that are exempt from the registration requirements of Section 5. Further, the safe harbor proposed in Rule 12g5-1(a)(7)(ii) would be available to securities issued in those transactions as long as the person received the securities pursuant to a compensatory benefit plan in transactions that met the conditions of Securities Act Rule 701(c). Should the scope of the safe harbor be more limited, such as by restricting it to securities received pursuant to exempt transactions that meet all of the requirements of Securities Act Rule 701, the requirements of Regulation D or another specified subset of exemptions? If so, please explain why.

12. We are proposing a non-exclusive safe harbor that relies, in part, on existing Rule 701(c) to establish guidelines for an issuer to use when determining whether holders of their securities received them pursuant to an employee compensation plan. Does using existing Rule 701(c) provide sufficient guidance to issuers? Should we provide additional guidance for implementing the safe harbor? If so, please explain what additional guidance is needed.

13. For purposes of the safe harbor, should we limit the categories of persons who may receive securities pursuant to employee compensation plans? For example, our proposed safe harbor includes consultants and advisors because they qualify under Rule 701. Should they only be included if they are natural persons and meet the other Rule 701(c) conditions, as proposed? Alternatively, should consultants and advisors be excluded?

14. Should we, as proposed, permit securities held by family member transferees acquired by gift or domestic relations order, or securities acquired by them in connection with options transferred to them by the plan participant through gifts or domestic

relations orders to be excluded? If we modify the scope of the transferees or the type of securities, what modifications would be appropriate?

15. Exchange Act Rules 12h-1(f) and12h-1(g) exempt compensatory employee stock options from registration under Exchange Act Section 12(g) by exempting issuers from counting holders of stock options received pursuant to written compensatory stock option plans under specified conditions.[88] How does the exclusion provided by Section 502 of the JOBS Act and our proposals, including our proposal to exclude securities that do not involve a sale under Section 2(a)(3) of the Securities Act, affect the continuing need for these rules?[89] Should either Rule 12h-1(f) or Rule 12h-1(g) be rescinded in light of the amendments made by Section 502 of the JOBS Act and our proposals? Alternatively, are there any modifications needed to reflect the changes related to Section 502 and make the rules more useful?

16. Should we permit an issuer to exclude from the "held of record" determination securities issued to security holders in an exchange exempt from registration under the Securities Act where the securities surrendered by those holders in the exchange were received by them pursuant to a compensatory benefit plan that met the conditions of the proposed rule? As proposed, the exclusion would be limited to securities issued in an exchange exempt from Securities Act registration to persons eligible to receive securities pursuant to Rule 701(c) from the issuer, such as former employees who were employed by or providing services to the surviving issuer at the time the exchange securities were

88 See Compensatory Stock Options Release, supra note 57.

89 See letter from ABA, which suggested that while Rule 12h-1(f) may no longer be necessary, Rule 12h-1(g) may have continuing applications. Specifically, there may be instances in which an issuer subject to an Exchange Act reporting requirement may issue to employees compensatory options that are part of a class of equity securities not registered under the Exchange Act.

offered. Should the Commission consider expanding the exclusion to securities received by other former employees in such an exempt exchange where the securities to be surrendered in the exchange were received pursuant to a compensatory benefit plan in transactions that met the conditions of the proposed rule? Would the possibility that an exempt exchange could cause a number of former employees previously counted as exempt from the "held of record" determination to be counted as holders of record immediately on consummation of the exchange inhibit companies from entering into these transactions?

17. Foreign private issuers are subject to different standards relating to when they are required to register a class of equity securities under the Exchange Act. Should the Commission permit foreign private issuers to exclude securities received pursuant to an "employee compensation plan" in transactions exempt from, or not subject to, the Securities Act registration requirements from the 300 U.S. holders threshold in Exchange Act Rule 12g3-2(a), as proposed? Should we instead require foreign private issuers to continue counting these securities when determining their number of U.S. holders? Should we further permit issuers to exclude such securities for purposes of assessing whether an issuer qualifies as a foreign private issuer or should such securities be included in this determination, as would be required under our proposed amendments to Securities Act Rule 405 and Exchange Act Rule 3b-4?

IV. GENERAL REQUEST FOR COMMENT

We request and encourage any interested person to submit comments regarding the proposed rule amendments, specific issues discussed in this release, and other matters that may have an effect on the proposed rules. We request comment from the point of view of issuers, investors and other market participants. We note that comments are of particular assistance to us if accompanied by supporting data and analysis of the issues addressed in those comments, particularly quantitative information as to the costs and benefits. If alternatives to the proposals are suggested, supporting data and analysis and quantitative information as to the costs and benefits of those alternatives are of particular assistance. Commenters are urged to be as specific as possible.

Request for Comment

18. Are there other rules or forms that should be revised or updated as a result of the statutory changes made by Title V and Title VI of the JOBS Act? If so, please explain what revisions are needed?

19. The definition of "held of record" in Exchange Act Rule 12g5-1 requires an issuer, for the purposes of determining whether it is subject to the provisions of Section 12(g) or Section 15(d), to count as holders of record only persons identified as owners on records of security holders maintained by or on behalf of the issuer in accordance with accepted practice and subject to certain conditions. This rule simplifies an issuer's determination process by allowing it to look to security holders that appear in its records. Are there alternative definitions of "held of record" that would more appropriately address the purposes of Section 12(g)?[90]

V. ECONOMIC ANALYSIS

Title V and Title VI of the JOBS Act increased the registration thresholds for issuers, amended the definition of "held of record" to exclude securities issued pursuant to employee compensation plans and increased the thresholds for termination of registration and suspension of reporting under the Exchange Act for banks and bank

[90] In its consideration of the JOBS Act, Congress considered other definitions of "held of record" but ultimately did not define the term for purposes of the provisions of Section 12(g).

holding companies. The Commission is proposing rules to implement Title V and Title VI of the JOBS Act.

In proposing rules or amendments, we are mindful of the costs imposed by and the benefits obtained from our rules. The discussion below attempts to address the economic effects of the proposed amendments, including the likely costs and benefits of the amendments as well as the effect of the amendments on efficiency, competition and capital formation.[91] Some of the costs and benefits stem from the statutory mandates of Title V and Title VI, while others are affected by the discretion we exercise in revising our rules to reflect this mandate. These two types of costs and benefits may not be entirely separable to the extent our discretion is exercised to realize the benefits that we believe were intended by Title V and Title VI. We request comment on all aspects of the economic effects, such as the costs and benefits, of the amendments that we are proposing. We particularly appreciate comments that distinguish between the economic effects that are attributed to the statutory mandate itself and the economic effects that are the result of policy choices made by the Commission in implementing the statutory mandate.

A. Baseline

The baseline for our economic analysis of the proposed rules, including the baseline for our consideration of the effects on efficiency, competition and capital

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91 Section 23(a)(2) of the Exchange Act requires the Commission, when making rules under the Exchange Act, to consider the impact on competition that the rules would have, and prohibits the Commission from adopting any rule that would impose a burden on competition not necessary or appropriate in furtherance of the Exchange Act. 15 U.S.C. 78w(a). Further, Section 2(b) of the Securities Act [15 U.S.C. 77b(b)] and Section 3(f) of the Exchange Act [17 U.S.C. 78c(f)] require the Commission, when engaging in rulemaking where it is required to consider or determine whether an action is necessary or appropriate in the public interest, to consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.

formation, is the state of the market as well as market practices prior to the JOBS Act. Prior to the JOBS Act, issuers were required to register their equity securities with the Commission upon reaching 500 holders of record and total assets of $10 million, and were allowed to terminate registration or suspend the duty to file with the Commission when the number of holders of record had fallen below 300. However, Exchange Act Rules 12h-1(f) and 12h-1(g) permitted issuers to exclude stock options issued under written compensatory benefit plans under certain conditions from the registration requirements of Section 12(g).

The JOBS Act raised the thresholds at which an issuer is required to register a class of equity securities with the Commission pursuant to Section 12(g), provided that persons holding certain employee compensation plan securities need not be counted when determining whether an issuer is required to register, and raised the thresholds at which banks and bank holding companies are permitted to terminate registration or suspend reporting obligations with the Commission. These statutory changes made by the JOBS Act went into effect as soon as the JOBS Act was signed into law. As a result of the JOBS Act, some banks and bank holding companies were newly eligible to terminate registration or suspend reporting, and as of June 30, 2014, we estimate that more than 90 have elected to do so.[92] We estimate that there are approximately 500 banks and bank holding companies that currently report to the Commission,[93] of which some may be eligible to terminate registration under the JOBS Act but have elected to continue

[92] The Commission staff derived this estimate of the number of banks and bank holding companies that have elected to terminate registration or suspend reporting by analyzing Form 15 filings on EDGAR. Commission staff is continuing to monitor such filings.

[93] The Commission staff derived this estimate by analyzing annual filings submitted to the Commission during calendar year 2013.

reporting. We are proposing to amend specified Exchange Act rules to reflect the new, higher threshold for banks and bank holding companies under Section 12(g)(4) and Section 15(d)(1). For those banks and bank holding companies that would be eligible to terminate registration under Section 12(g), the proposed rules set forth procedural accommodations that are available to other issuers under current rules to accelerate the process.

The proposed rules would also permit savings and loan holding companies to use the same, higher thresholds for registration, termination of registration and suspension of the reporting obligation that apply to banks and bank holding companies. There are approximately 125 savings and loan holding companies that currently report to the Commission.[94] As we explain in more detail below, we estimate that approximately 90 would be eligible to terminate registration or suspend reporting under the proposed rules.

In addition, the proposed rules would apply the definition of "accredited investor" in Securities Act Rule 501(a) in making determinations under Exchange Act Section 12(g)(1). Finally, the proposed rules would revise the definition of "held of record" and establish the scope of a non-exclusive safe harbor for issuers to rely on when determining whether securities were received pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the Securities Act or did not involve a sale within the meaning of Section 2(a)(3) of the Securities Act. The proposed safe harbor would rely on the definition of "compensatory benefit plan" in Securities Act Rule 701 and the conditions in Securities Act Rule 701(c).

We considered alternative definitions of "employee compensation plan." We also

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94 Id.

considered whether to provide additional guidance with respect to the determination of accredited investor status when establishing the number of holders of record. These decisions may affect how a non-reporting issuer counts its holders of record for the purpose of the registration thresholds under the Exchange Act; hence it could affect whether an issuer can remain a non-reporting issuer. However, due to limited availability of shareholder information on these non-reporting issuers, we are unable to quantify the number of non-reporting issuers that might be affected by these decisions.

B. Analysis of the Proposed Rules

The proposal would affect registrants generally, and banks, bank holding companies and savings and loan holding companies specifically, as well as non-reporting issuers, employees and other investors. We analyze the costs and benefits associated with the proposed rules below.

Increased thresholds for banks and bank holding companies

The JOBS Act amended Sections 12(g) and 15(d) of the Exchange Act to raise the thresholds at which banks and bank holding companies may terminate registration or suspend their obligations to file reports with the Commission to 1,200 holders of record. These changes were effective immediately upon the enactment of the JOBS Act, and banks and bank holding companies may rely on the amended provisions to terminate registration or suspend their reporting obligations. However, under the statute, banks and bank holding companies that want to use the higher threshold must wait 90 days after filing a certification with the Commission that the number of holders of record is less than 1,200 persons to terminate their Section 12(g) registration and cease filing reports required by Section 13(a) and must wait until the first day of the fiscal year to suspend any Section 15(d) reporting obligations. Our existing rules afford issuers with procedural accommodations that let them suspend their reporting obligations immediately upon the filing of a certification on Form 15. To make these procedural accommodations applicable to banks and bank holding companies at the higher threshold, we are proposing to revise Exchange Act Rules 12g-2, 12g-3, 12g-4 and 12h-3 to reflect the 1,200 holders threshold for banks and bank holding companies, which would permit banks and bank holding companies to rely on the rules to cease reporting during a fiscal year, rather than wait the prescribed 90 days or until the end of the reporting year. This would reduce issuer compliance and reporting costs during the fiscal year the issuer ceased reporting, but would also accelerate the loss of investor access to current information about the issuer. The proposed changes also would harmonize the statutory and regulatory thresholds and lessen potential confusion that could arise from the differences in the thresholds contained in the statute and the existing rules.

We estimate that there are approximately 500 banks and bank holding companies that currently report with the Commission. Many of these reporting issuers have more than 1,200 holders of record and would not be eligible to cease reporting under the new thresholds. Out of that 500, 143 reporting banks and bank holding companies have between 300 and 1,200 holders of record and may be eligible to cease reporting, although 89 of them would have to give up a national exchange listing to do so. Because banks and bank holding companies remain subject to other regulatory reporting requirements,[95] it is possible that they would continue reporting even if they are eligible to cease reporting under the Exchange Act. We anticipate that banks and bank holding companies would weigh the benefits of being a public company against the burden of additional

95 See supra note 41.

disclosure costs, in deciding whether to terminate registration or suspend their reporting obligation. Commonly cited benefits of being a public company include the ability to obtain a lower cost of capital for investment and growth, increased liquidity through a broader shareholder base, and greater ability to finance acquisitions and offer equity-based incentive contracts.[96] Commonly cited costs of being a public company include the need to comply with increased regulations and regulatory supervision, including requirements for independent audits, disclosure of information to competitors, loss of control and ownership dilution.[97]

Permitting savings and loan holding companies to use the higher thresholds

We are proposing to apply the 2,000-holders of record threshold for registration to savings and loan holding companies in revised Exchange Act Rule 12g-1. We are also proposing to extend the increased thresholds established by Section 601 of the JOBS Act to savings and loan holding companies by specifically including them in revisions to Exchange Act Rules 12g-2, 12g-3, 12g-4 and 12h-3 that accommodate banks and bank holding companies at the higher 1,200 holders of record threshold for termination of

96 See J. Brau, Why Do Firms Go Public?, Oxford Handbook of Entrepreneurial Finance (2010) (providing a general discussion of the different rationales for firms to go public); U.Celikyurt, M. Sevilir, and A. Shivdasani, Going Public to Acquire? The Acquisition Motive in IPOs, J. FIN. ECON. (2010) (arguing that firms go public so as to facilitate acquisitions); M. Pagano, F. Panetta, and L. Zingales, Why Do Companies Go Public? An Empirical Analysis, J. FIN. (1998) (showing that IPOs are generally followed by lower cost of credit and increased turnover in control); T. Chemmanur and P. Fulghieri, A Theory of the Going Public Decision, REV. FIN.STUD. (1999) (arguing that going public broadens the ownership base of the firm); R. Rosen, S. Smart and C. Zutter, Why Do Firms Go Public? Evidence From the Banking Industry, Working Paper (2005) (finding that banks that go public are more likely to grow faster, earn higher profits, employ more leverage and become acquirers when compared to their non-reporting counterparts).

97 See J. Brau and S. Fawcett, Initial Public Offerings: An Analysis of Theory and Practice, J. FIN. (2006) (reporting based on a survey of CFOs that "desire to maintain decision-making control," "disclosing information to competitors," "SEC reporting requirements" and "to avoid ownership dilution" are among the top five reasons why firms choose to stay private); J. Farre-Mensa, Why Are Most Firms Privately Held?, Working paper, Harvard University (2011) (documenting that firms in industries with high disclosure costs (i.e., where it is easier for competitors to appropriate a firm's intellectual property) tend to remain private).

registration or suspension of the duty to file reports. As a result, savings and loan holding companies would be able to delay registration with the Commission until they reach the 2,000-holder threshold, and savings and loan holding companies with between 300 and 1,199 holders of record would be newly eligible to terminate or suspend their Exchange Act reporting obligations.

We estimate that approximately 125 savings and loan holding companies had a class of securities registered pursuant to the Exchange Act as of June 30, 2014;[98] of these approximately 100 are registered pursuant to Section 12(b). By analyzing the number of holders of record for these companies, the staff determined that approximately 90 of the 125 savings and loan holding companies would be eligible to terminate registration or suspend reporting. Most of the newly eligible companies would have to give up a national securities exchange listing to do so. Because delisting from a national securities exchange could severely impact the liquidity of traded securities, many of these savings and loan holding companies may be unwilling to suspend their reporting requirements even if such an action was available to them. We therefore do not expect many of these savings and loan holding companies to avail themselves of the extended provisions.

If we do not extend the provisions of Section 601 to savings and loan holding companies, there would be inconsistent treatment relative to banks and bank holding companies, resulting in different registration requirements and levels of disclosure for savings and loan holding companies that provide similar services and are generally subject to the same regulatory requirements. This could have an adverse impact on their ability to compete. Alternatively, savings and loan holding companies could seek to

98 The Commission staff derived this estimate by analyzing annual filings submitted to the Commission.

become chartered as banks or bank holding companies and thereby incur associated costs; this could distort the competitive balance of products and services offered by these institutions.

Applying consistent treatment between savings and loan holding companies and banks and bank holding companies would lessen the likelihood of changes to the current competitive balance between these institutions. Moreover, the potential loss of information that would otherwise be made public through Exchange Act reporting if the provisions of Section 601 are extended to savings and loan holding companies would be mitigated because the savings and loan holding companies would continue to file reports with banking regulators.[99] As a result, extending the relief to savings and loan holding companies to provide consistent treatment relative to banks and bank holding companies may have a positive impact on the overall efficiency of markets served by the potentially affected institutions.

Definition and safe harbor for securities "held of record"

Section 12(g)(5), as amended by Section 502 of the JOBS Act, excludes from the definition of "held of record" securities held by persons who received them pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the Securities Act for purposes of determining whether an issuer is required to register a class of security pursuant to Section 12(g)(1). Section 503

99 While the proposed rules should have effects on competition by ensuring that savings and loan holding companies are not put at a disadvantage relative to banks and bank holding companies, the termination of registration or suspension of reporting by savings and loan holding companies may lessen the information available to investors and adversely affect efficiency and capital formation by possibly increasing information asymmetries, monitoring costs, and cost of capital. However, the impact on efficiency and capital formation may be mitigated to the extent that the reports that savings and loan holding companies file with banking regulators contain information comparable to that mandated by the reporting requirements under the Exchange Act.

of the JOBS Act directs the Commission to adopt a safe harbor that issuers can use when making the holder of record determination. By making it easier for non-reporting companies that issue securities to their employees to remain below the registration and reporting thresholds in the Exchange Act, the statutory changes could benefit issuers by allowing them to better control how and when they become subject to the reporting requirements, while continuing to use securities to compensate employees. These changes could be particularly beneficial for smaller or cash-constrained issuers that could more easily issue securities to their employees as a form of compensation without being subject to Exchange Act reporting requirements and the associated compliance costs. However, for these issuers, the potential registration of a class of securities and the associated reporting may be delayed, adversely impacting investors, including employees, who otherwise might benefit from the information provided through Exchange Act reporting requirements. As a result, the proposed rules regarding the definition of "held of record" and the scope of the safe harbor could have an impact on the potential costs and benefits to the affected issuers and their investors by affecting areas such as the ease of relying upon the statutory exemption, the number of non-reporting companies able to forestall registration, and the amount of information available to investors in those issuers.

Instead of establishing a new definition for the term "employee compensation plan," we are proposing to amend the definition of "held of record" to permit an issuer to exclude securities held by persons who received them pursuant to an employee compensation plan in transactions exempted from the registration requirements of Section 5 of the Securities Act, or not involving a sale within the meaning of Section 2(a)(3) of the Securities Act. Proposing to exclude securities issued to employees in transactions that do not involve a sale under Section 2(a)(3) from the definition of "held of record" for purposes of determining an issuer's obligation to register a class of securities under the Exchange Act would be beneficial to issuers who rely on the "no sale" theory when making compensatory grants to certain employees. Excluding such "no sale" securities could reduce the number of holders of record of an issuer and potentially delay required Exchange Act reporting.

We are also proposing to establish a non-exclusive safe harbor that relies on Securities Act Rule 701(c) and the definition of "compensatory benefit plan" in that rule to assist issuers in making the determination of whether holders of securities received pursuant to an employee compensation plan may be excluded. We believe that relying on an existing definition that is already understood by market participants would make it easier for issuers to avail themselves of this safe harbor than if we proposed a new alternative definition. The proposed non-exclusive safe harbor relies upon the conditions in existing Rule 701(c). While generally broad in application, the conditions in Rule 701(c) provide limitations, such as requiring that securities be sold under a compensatory benefit plan, that the plan be written, that the plan be established by the issuer or certain specified related entities and that participation be limited to employees and certain other specified persons. Although we are unable to quantify the impact of proposing this safe harbor because we cannot measure the number of issuers that would rely on the safe harbor, we can qualitatively assess the proposed safe harbor's impact. A safe harbor that applies the familiar concepts of existing Rule 701(c) should create efficiencies in applying the safe harbor and avoid conflicts with existing rules, which should reduce costs more significantly for smaller issuers seeking to rely upon the proposed safe harbor.

Foreign private issuers would be able to rely on the proposed safe harbor when making their determination of the number of U.S. resident holders under Exchange Act Rule 12g3-2(a). While we are unable to quantify the number of foreign private issuers that would be impacted, we acknowledge that it may allow some foreign private issuers to delay registering with and reporting to the Commission. The considerations about cost and benefit tradeoffs for foreign private issuers would be analogous to the ones discussed above for domestic issuers.

Use of the term "accredited investor" in Exchange Act Section 12(g)

Section 501 of the JOBS Act raises the threshold number of holders of record at which an issuer is required to register a class of equity securities under the Exchange Act to 2,000 persons or 500 persons who are not accredited investors. The provision was effective upon enactment of the JOBS Act. In order for an issuer to rely on the new, higher threshold established by the JOBS Act, the issuer will need to be able to make accredited investor determinations if it has more than 500 holders of record.

We propose that the definition of "accredited investor" as specified in Securities Act Rule 501(a) determined as of the last day of the fiscal year rather than at the time of sale of the securities apply when making determinations under Exchange Act Section 12(g)(1). Issuers are familiar with this definition, which should facilitate compliance. Developing an alternative definition for purposes of Section 12(g)(1) could impose costs on issuers by requiring them to familiarize themselves with, and apply, a new and different standard. We are unable to estimate how many issuers would be impacted by using the Rule 501(a) definition of "accredited investor" as compared to an alternative definition. We acknowledge that not providing specific guidance or rules on how to confirm a security holder's status as an accredited investor for purposes of determining holders of record could result in some uncertainty for issuers.

Some commenters have recommended that the Commission address potential compliance issues related to the accredited investor threshold by providing a safe harbor for determining accredited investor status.[100] We could, among other things, permit an issuer to rely on an annual affirmation of accredited investor status by the investor or rely on an ongoing basis on information regarding accredited investor status received by the issuer at the time the securities were initially issued to the investor or at the time the securities were most recently issued to the investor, or permit issuers to otherwise rely on information previously provided by an investor.

Addressing potential compliance issues relating to the use of "accredited investor" in Section 12(g) could increase efficiency by providing issuers with a prescribed process to determine and update the accredited investor status of their investors. For example, a safe harbor that permits an issuer to rely on an annual affirmation of accredited investor status by the investor, other information obtained by the issuer or on a combination of a certification and other information would likely be less costly than requiring an issuer to establish a reasonable basis for its determination through other means. These methods, however, may be less accurate in establishing whether the investor is accredited.

Alternatively, a safe harbor that permits an issuer to rely on an ongoing basis on information previously obtained relating to accredited investors status, such as allowing reliance on information obtained by the issuer at the time the securities were initially issued to the investor or at the time the securities were most recently issued to the investor would likely be even less costly than requiring the issuer to seek an annual affirmation of accredited investor status by the investor or to establish a reasonable belief

100 See, e.g., letters from ABA, Foley & Lardner and NYCBA.

that the investor is an accredited investor, but could also lead to more outdated information. Permitting issuers to rely on inaccurate information to determine accredited investor status could result in issuers with more than 500 non-accredited investors failing to register and leaving investors in those issuers with less information and protection under the federal securities laws. These costs may be mitigated if the safe harbor specified time limits on the permitted use of the information or if the safe harbor were conditioned upon the issuer not having information that the previously obtained information was incorrect, unreliable or had changed.

Another alternative would be a safe harbor that permits an issuer to rely on a third party certification for determining the accredited investor status of investors. We do not have adequate information about third party certification providers and the characteristics of this industry to assess this alternative in terms of reliability and cost of the provided certification services. To the extent that reputational concerns would incentivize the third party certification providers to perform reliable and updated due diligence, third party certification could potentially provide accurate information at a cost that economies of scale may lessen.

Request for Comment

18. In this release we have discussed the anticipated costs and benefits of the proposed rules. We request data to quantify the costs and the value of the benefits described throughout this release. We seek estimates of these costs and benefits, as well as any costs and benefits not described, that may result from the adoption of these proposed amendments. We also request comments on the qualitative benefits and costs we have identified and any benefits and costs we may have overlooked.

VI. PAPERWORK REDUCTION ACT

Certain provisions of our disclosure rules and forms applicable to issuers contain "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995 ("PRA").[101] The hours and costs associated with preparing and filing forms and retaining records constitute reporting and cost burdens imposed by the collection of information requirements. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information requirement unless it displays a currently valid Office of Management and Budget ("OMB") control number. Compliance with the information collections is mandatory. Responses to the information collections are not kept confidential and there is no mandatory retention period for the collections of information.

The amendments proposed today do not alter the disclosure requirements set forth in the rules and forms; however, the JOBS Act amendments to Exchange Act Sections 12(g) and 15(d) and the proposed amendments to our rules to reflect those statutory amendments are expected to immaterially decrease the number of filings made pursuant to these rules and forms. Exchange Act Rules 12g-1, 12g-2, 12g-3, 12g-4 and 12h-3 set forth when an issuer's securities are required to be registered and the procedures for a registrant to terminate its registration or suspend its duty to file reports. The proposed amendments would provide thresholds that issuers may rely on when determining their registration and reporting obligations and would allow savings and loan holding companies to use the same registration and termination of registration or suspension of

[101] 44 U.S.C. 3501 et seq.

reporting thresholds that apply to banks and bank holding companies.[102] Exchange Act Section 12(g)(5) and the proposed amendment to Exchange Act Rule 12g5-1 also exclude securities received pursuant to certain employee compensation plans from the determination of when an issuer is required to initially register with the Commission. These changes would reduce the number of registrants required to continue filing with the Commission and also reduce the number of issuers required to initially register a class of securities.[103] For purposes of the PRA, we estimate that the amendments would not materially reduce the number of filings received, nor would the changes affect the incremental burden or cost per filing.

The titles for the affected collections of information are:

(1) "Form 10" (OMB Control No. 3235-0064);[104]

(2) "Form 20-F" (OMB Control No. 3235-0288);[105]

(3) "Form 40-F" (OMB Control No. 3235-0381);[106]

(4) "Form 10-K" (OMB Control No. 3235-0063);[107]

(5) "Form 10-Q" (OMB Control No. 3235-0070);[108]

(6) "Form 8-K" (OMB Control No. 3235-0060);[109]

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102 We are proposing to amend Rule 12g-1 to reflect the new higher thresholds in Section 12(g)(1) and to establish an increased registration threshold for savings and loan holding companies.

103 The changes to Rule 12g5-1 are expected to affect the number of issuers required to register with the Commission; however, we do not have access to data to support an estimate of the number of issuers that will not be required to file reports based on the JOBS Act amendments and our proposed implementation of such amendments. Due to the lack of data, for PRA purposes we are not intending to provide a reduced estimate of the number of issuers.

104 17 CFR 249.10.

105 17 CFR 249.220f.

106 17 CFR 249.240f.

107 17 CFR 249.310.

108 17 CFR 249.308a.

109 17 CFR 249.308.

(7) "Schedule 14A" (OMB Control No. 3235-0059); [110]

(8) "Schedule 14C" (OMB Control No. 3235-0057);[111]

(9) "Form 15" (OMB Control No. 3235-0167).

The forms were adopted under the Exchange Act and set forth the disclosure requirements for periodic, current and other reports required to be filed by issuers registered with the Commission.

We estimate that there are approximately 625 Exchange Act registrants that are bank holding companies or savings and loan holding companies. We estimate that approximately 90 bank holding companies have filed Forms 15 to terminate or suspend their reporting obligations under the Exchange Act based on the statutory changes in the JOBS Act.[112] We further estimate that approximately 90 savings and loan holding companies or similar entities with fewer than 1,200 holders of record would be eligible to file a Form 15 after our proposed changes. To put these numbers in context, the current PRA estimate for the number of annual reports on Form 10-K filed annually is 8,137. Because the proposed rule amendments do not affect our estimates of the burden or cost per filing and we do not anticipate a material decrease in the number of filings as a result of the proposed rule amendments, we are not submitting revised burden estimates for these collections of information to OMB for review in accordance with the PRA and its implementing regulations at this time.[113]

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110 17 CFR 240.14a-101.

111 17 CFR 240.14c-101.

112 After the JOBS Act became effective, we saw an increase in the number of termination and suspension of registrations by bank holding companies. We do not anticipate a similar rate of deregistration for bank holding companies after revising our rules to reflect the new, higher deregistration threshold.

113 44 U.S.C. 3507(d); 5 CFR 1320.11.

We request comment on our approach and the accuracy of the current estimates. Pursuant to 44 U.S.C. 3506(c)(2)(A), the Commission solicits comments to: (1) evaluate whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (2) evaluate the accuracy of the Commission's estimate of burden of the collection of information; (3) determine whether there are ways to enhance the quality, utility and clarity of the information to be collected; and (4) evaluate whether there are ways to minimize the burden of the collection of information on those who are required to respond, including through the use of automated collection techniques or other forms of information technology.

Persons submitting comments on the collection of information requirements should direct the comments to the Office of Management and Budget, Attention: Desk Officer for the Securities and Exchange Commission, Office of Information and Regulatory Affairs, Washington, DC 20503, and send a copy to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090, with reference to File No. S7-12-14. Requests for materials submitted to OMB by the Commission with regard to these collections of information should be in writing, refer to File No. S7-12-14, and be submitted to the Securities and Exchange Commission, Office of FOIA Services, 100 F Street, NE, Washington, DC 20549-2736. OMB is required to make a decision concerning the collection of information between 30 and 60 days after publication of this release. Consequently, a comment to OMB is assured of having its full effect if OMB receives it within 30 days of publication.

VII. SMALL BUSINESS REGULATORY ENFORCEMENT FAIRNESS ACT

For purposes of the Small Business Regulatory Enforcement Fairness Act of 1996 ("SBREFA"),[114] the Commission must advise OMB as to whether a proposed regulation constitutes a "major" rule. Under SBREFA, a rule is considered "major" where, if adopted, it results or is likely to result in:

- an annual effect on the economy of $100 million or more (either in the form of an increase or a decrease);
- a major increase in costs or prices for consumers or individual industries; or
- significant adverse effects on competition, investment or innovation.

If a rule is "major," its effectiveness will generally be delayed for 60 days pending Congressional review.

We request comment on whether our proposed amendments would be a "major rule" for purposes of SBREFA. We solicit comment and empirical data on:

- the potential effect on the U.S. economy on an annual basis;
- any potential increase in costs or prices for consumers or individual industries; and
- any potential effect on competition, investment or innovation.

We request those submitting comments to provide empirical data and other factual support for their views to the extent possible.

VIII. INITIAL REGULATORY FLEXIBILITY ACT ANALYSIS

The Commission has prepared this Initial Regulatory Flexibility Act Analysis in accordance with 5 U.S.C. 603. This Initial Regulatory Flexibility Act Analysis relates to

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114 Pub. L. No. 104-121, Tit. II, 110 Stat. 857 (1996).

the proposed amendments to Securities Act Rule 405 and Exchange Act Rules 3b-4, 12g-1, 12g-2, 12g-3, 12g-4, 12g5-1, and 12h-3.

A. Reasons for, and Objectives of, the Proposed Action

The primary reason for, and objective of, the proposed amendments is to implement Title V and Title VI of the JOBS Act. The JOBS Act directs the Commission to issue rules to implement the changes and specifically charges the Commission with amending the definition of "held of record" and establishing a safe harbor for the determination relating to "employee compensation plan" securities. We are proposing rules that would revise existing rules to reflect the new, higher Exchange Act registration, termination of registration and suspension of reporting thresholds for banks and bank holding companies, apply the definition of "accredited investor" in Securities Act Rule 501(a) in making determinations under Exchange Act Section 12(g)(1), revise the definition of "held of record" to exclude certain securities held by persons who received them pursuant to employee compensation plans, and establish a non-exclusive safe harbor for issuers to follow when determining whether those securities are "held of record." We are also proposing to provide relief from the Exchange Act registration requirements for savings and loan holding companies by applying the same thresholds to savings and loan holding companies that apply to banks and bank holding companies. Permitting savings and loan holding companies to register, terminate registration and suspend reporting using the same thresholds as banks and bank holding companies would provide consistent treatment across depository institutions. Revising the definition and providing a non-exclusive safe harbor to issuers relating to the determination of securities "held of record" would further assist issuers in determining which holders of record they are required to count under the registration requirements of Exchange Act Section 12(g).

B. Small Entities Subject to the Proposed Rules

For purposes of the Regulatory Flexibility Act, an investment company is a small entity if it, together with other investment companies in the same group of related investment companies, has net assets of $50 million or less as of the end of its most recent fiscal year.[115] Exchange Act Rule 0-10(a)[116] defines an entity, other than an investment company, to be a "small business" or "small organization" if it had total assets of $5 million or less on the last day of its most recent fiscal year. We estimate that there are approximately 900 issuers that are required to file with the Commission, other than investment companies, that may be considered small entities.

The proposed rules establishing the use of the Securities Act Rule 501(a) definition of "accredited investor" under Exchange Act Section 12(g)(1) and amending the definition of "held of record" to exclude certain securities held by persons who received them pursuant to employee compensation plans and establishing a non-exclusive safe harbor for issuers to follow when determining whether those securities are "held of record" may affect small issuers relying on the revised rules and safe harbor to determine the number of holders of record. While an issuer is not required to register a class of equity securities pursuant to Section 12(g) of the Exchange Act until the issuer's total assets exceed $10 million, a small business or small organization may rely on the rules when determining to whom to issue securities and whether to compensate employees with securities. By providing guidance on the meaning of the term "accredited investor" in the Exchange Act context, the proposed rules may facilitate private offerings and the ability of an issuer to determine their registration and reporting obligations. By excluding

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115 17 CFR 270.0-10(a).

116 17 CFR 240.0-10(a).

certain employee compensation securities from the definition of "held of record," the proposed rules would facilitate the use of equity compensation by small issuers, thereby helping them to preserve cash and giving them greater ability to determine when the Exchange Act Section 12(g) registration obligation would be triggered.

We cannot estimate the number of small entities affected by these proposed rules. By definition, they are not yet subject to Section 12(g) registration and reporting requirements, which are triggered by the issuer having total assets exceeding $10 million as of the last day of its fiscal year. We do not otherwise have information about the number of shareholders at small entities, including those who have received securities as a result of employee compensation plans. We request comment on the number of small entities that would be impacted by our proposals, including any available empirical data.

C. Projected Reporting, Recordkeeping and Other Compliance Requirements

When determining whether an issuer must register under Section 12(g)(1), the issuer would be permitted to rely on the proposed rules. The proposed use of the Securities Act Rule 501(a) definition of "accredited investor" and safe harbor under the proposed amendment to the definition of "held of record" would assist an issuer in determining the number of holders of record. In order for an issuer to rely on the safe harbor, the securities would need to be issued in a transaction exempt from, or not subject to, the registration requirements and satisfy the requirements of Rule 701(c), which includes the requirement that the securities be offered or sold under a written compensatory benefit plan or written compensation contract. In addition, issuers seeking to rely upon the safe harbor may need to maintain records to help establish their compliance with the safe harbor conditions. We are not aware of any other recordkeeping or compliance requirements associated with the proposed definition and safe harbor.

The proposed rules and amendments affecting banks, bank holding companies and savings and loan holding companies would not add any new reporting, recordkeeping or other compliance requirements on those entities and we are not aware of any bank, bank holding company, or savings and loan holding company registrants with less than \$5 million in assets. The proposed rules would raise the thresholds relating to registration for those entities and reduce their compliance burdens.

D. Duplicative, Overlapping or Conflicting Federal Rules

The Commission believes that there are no rules that duplicate, overlap or conflict with the proposed rules or amendments.

E. Significant Alternatives

Pursuant to Section 3(a) of the Regulatory Flexibility Act,[117] the Commission must consider certain types of alternatives, including: (1) the establishment of differing compliance or reporting requirements or timetables that take into account the resources available to small entities; (2) the clarification, consolidation or simplification of compliance and reporting requirements under the rule for small entities; (3) the use of performance rather than design standards; and (4) an exemption from coverage of the rule, or any part of the rule, for small entities.

We are proposing that the current definition of "accredited investor" in Securities Act Rule 501(a) apply in making determinations under Exchange Act Rule 12g-1(b)(1). We could develop a new definition of "accredited investor" for purposes of Section

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117 5 U.S.C. 603(c).

12(g)(1); however, given the prevalence of the use of Regulation D for exempt offerings, many issuers are familiar with and rely upon the definition in Rule 501(a). The increased registration threshold established by the JOBS Act is intended to permit issuers, including small entities, to defer Exchange Act registration until issuers have a larger shareholder base. Because proposed Rule 12g-1(b)(1) is intended to facilitate an issuer's ability to make the determination of when it is required to register, we believe use of the familiar Rule 501(a) definition of "accredited investor" will further this regulatory objective for all issuers, including small entities.

The proposed amendment to the definition of "held of record" and related safe harbor, if adopted, would apply to all issuers, including small entities, that choose to exclude securities held by persons who received them pursuant to employee compensation plans in certain exempt transactions or transactions not involving a sale within the meaning of Securities Act Section 2(a)(3). The proposed amendment and safe harbor help define the contours of an exemption from registration for issuers that might otherwise cross the Section 12(g) registration thresholds.

The proposed rules are intended to permit issuers, including small entities, to exclude certain securities from the determination and to assist issuers in making that determination by clarifying and simplifying requirements for all entities. Establishing different compliance or reporting requirements relating to employee compensation plan securities or accredited investor determinations for small entities could complicate the rules and make them more difficult to apply as those issuers grow, cease to be small entities, and are required to determine whether they must register with the

Commission.[118] With respect to the use of performance standards rather than design standards, we note that the holder of record threshold is a statutorily created design standard, requiring issuers to register if their holders of record coupled with their total assets cross the threshold. As we are modifying the definition of "held of record" and clarifying the determination of "accredited investor" under this statutory design standard, we did not evaluate whether a performance standard would be more useful.

F. Solicitation of Comment

We are soliciting comments regarding this analysis. We request comment on the number of small entities that would be subject to the rules and whether the proposed rules would have any effects that have not been discussed. We request that commenters describe the nature of any effects on small entities subject to the rules and provide empirical data to support the nature and extent of the effects.

IX. STATUTORY AUTHORITY AND TEXT OF PROPOSED RULE AMENDMENTS

The amendments contained in this release are being proposed under the authority set forth in Section 19 of the Securities Act, as amended, Sections 3(b), 12(g), 12(h), 15(d) and 23(a) of the Exchange Act, as amended, and Section 503 and Section 602 of the JOBS Act.

List of Subjects in 17 CFR Parts 230 and 240

Reporting and recordkeeping requirements, Securities.

TEXT OF THE AMENDMENTS

For the reasons set out above, the Commission proposes to amend Title 17, chapter II of the Code of Federal Regulations, as follows:

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118 Under Section 12(g) an issuer is not required to register unless the issuer has total assets exceeding $10 million at the end of its fiscal year.

PART 230 - GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933

1. The authority citation for Part 230 continues to read, in part, as follows:

Authority: 15 U.S.C. 77b, 77b note, 77c, 77d, 77d note, 77f, 77g, 77h, 77j, 77r, 77s, 77z-3, 77sss, 78c, 78d, 78j, 78l, 78m, 78n, 78o, 78o-7 note, 78t, 78w, 78ll(d), 78mm, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, and Pub. L. 112-106, sec. 201(a), 126 Stat. 313 (2012), unless otherwise noted.

* * * * *

2. Amend § 230.405 by adding an Instruction to paragraph (1) to the definition of "Foreign private issuer" to read as follows:

§ 230.405 Definitions of terms

* * * * *

Foreign private issuer. (1) * * *

INSTRUCTION TO PARAGRAPH (1): To determine the percentage of outstanding voting securities held by U.S. residents:

A. Use the method of calculating record ownership in § 240.12g3-2(a) of this chapter, except that:

(1) The inquiry as to the amount of shares represented by accounts of customers resident in the United States may be limited to brokers, dealers, banks and other nominees located in:

(i) The United States,

(ii) The issuer's jurisdiction of incorporation, and

(iii) The jurisdiction that is the primary trading market for the issuer's voting securities, if different than the issuer's jurisdiction of incorporation; and

(2) Notwithstanding § 240.12g5-1(a)(7)(i)(A) of this chapter, the issuer shall not exclude securities held by persons who received the securities pursuant to an employee compensation plan.

B. If, after reasonable inquiry, the issuer is unable to obtain information about the amount of shares represented by accounts of customers resident in the United States, the issuer may assume, for purposes of this definition, that the customers are residents of the jurisdiction in which the nominee has its principal place of business.

C. Count shares of voting securities beneficially owned by residents of the United States as reported on reports of beneficial ownership provided to the issuer or filed publicly and based on information otherwise provided to the issuer.

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PART 240 - GENERAL RULES AND REGULATIONS, SECURITIES EXCHANGE ACT OF 1934

3. The general authority citation for part 240 is revised to read as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78c-3, 78c-5, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78n-1, 78o, 78o-4, 78o-10, 78p, 78q, 78q-1, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7201 et seq., and 8302; 7 U.S.C. 2(c)(2)(E); 12 U.S.C. 5221(e)(3), and 18 U.S.C. 1350, Pub. L. 111-203, 939A, 124 Stat. 1376, 2010, and Pub. L. No. 112-106, sec. 503 and 602, 126 Stat. 326 (2012), unless otherwise noted.

* * * * *

4. Amend § 240.3b-4 by revising the Instruction to Paragraph (c)(1) to read as follows:

§ 240.3b-4 Definition of "foreign government," "foreign issuer" and "foreign private issuer".

* * * * *

(c) * * *

INSTRUCTION TO PARAGRAPH (c)(1): To determine the percentage of outstanding voting securities held by U.S. residents:

A. Use the method of calculating record ownership in § 240.12g3-2(a), except that:

(1) Your inquiry as to the amount of shares represented by accounts of customers resident in the United States may be limited to brokers, dealers, banks and other nominees located in:

(i) The United States,

(ii) Your jurisdiction of incorporation, and

(iii) The jurisdiction that is the primary trading market for your voting securities, if different than your jurisdiction of incorporation; and

(2) Notwithstanding § 240.12g5-1(a)(7)(i)(A) of this chapter, you shall not exclude securities held by persons who received the securities pursuant to an employee compensation plan.

B. If, after reasonable inquiry, you are unable to obtain information about the amount of shares represented by accounts of customers resident in the United States, you may assume, for purposes of this definition, that the customers are residents of the jurisdiction in which the nominee has its principal place of business.

C. Count shares of voting securities beneficially owned by residents of the United States as reported on reports of beneficial ownership provided to you or filed publicly and based on information otherwise provided to you.

* * * * *

5. Revise § 240.12g-1 and the section heading and remove the authority citation following § 240.12g-1 to read as follows:

§ 240.12g-1 Registration of securities; Exemption from section 12(g).

An issuer is not required to register a class of equity security pursuant to section 12(g)(1) of the Act (15 U.S.C. 78*l*(g)(1)) if on the last day of its most recent fiscal year:

(a) The issuer had total assets not exceeding $10 million; or

(b) (1) The class of equity security was held of record by fewer than 2,000 persons or 500 persons who are not accredited investors (as such term is defined in § 230.501(a) of this chapter, determined on such day rather than at the time of the sale of the securities); or

(2) In the case of a bank; a savings and loan holding company, as such term is defined in section 10 of the Home Owners' Loan Act (12 U.S.C. 1461); or a bank holding company, as such term is defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841); the class of equity security was held of record by fewer than 2,000 persons.

6. Revise § 240.12g-2 to read as follows:

§ 240.12g-2 Securities deemed to be registered pursuant to section 12(g)(1) upon termination of exemption pursuant to section 12(g)(2)(A) or (B).

Any class of securities which would have been required to be registered pursuant to section 12(g)(1) of the Act (15 U.S.C. 78*l*(g)(1)) except for the fact that it was exempt from such registration by section 12(g)(2)(A) of the Act (15 U.S.C. 78*l*(g)(2)(A)) because it was listed and registered on a national securities exchange, or by section 12(g)(2)(B) of the Act (15 U.S.C. 78*l*(g)(2)(B)) because it was issued by an investment company registered pursuant to section 8 of the Investment Company Act of 1940 (15 U.S.C. 80a-8), shall upon the termination of the listing and registration of such class or the termination of the registration of such company and without the filing of an additional registration statement be deemed to be registered pursuant to section 12(g)(1) if at the time of such termination:

(a) The issuer of such class of securities has elected to be regulated as a business development company pursuant to sections 55 through 65 of the Investment Company Act of 1940 (15 U.S.C. 80a-54 through 64) and such election has not been withdrawn; or

(b) Securities of the class are not exempt from such registration pursuant to section 12 of the Act (15 U.S.C. 78*l*) or rules thereunder and all securities of such class are held of record by 300 or more persons, or in the case of a bank; a savings and loan holding company, as such term is defined in section 10 of the Home Owners' Loan Act (12 U.S.C. 1461); or a bank holding company, as such term is defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841); 1,200 or more persons.

7. Amend § 240.12g-3 by revising paragraphs (a)(2), (b)(2) and (c)(2) to read as follows:

§240.12g-3 Registration of securities of successor issuers under section 12(b) or 12(g).

(a) * * *

(2) All securities of such class are held of record by fewer than 300 persons, or in the case of a bank; a savings and loan holding company, as such term is defined in

section 10 of the Home Owners' Loan Act (12 U.S.C. 1461); or a bank holding company, as such term is defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841); 1,200 persons.

*   *   *

(b)   *   *   *

(2) All securities of such class are held of record by fewer than 300 persons, or in the case of a bank; a savings and loan holding company, as such term is defined in section 10 of the Home Owners' Loan Act (12 U.S.C. 1461); or a bank holding company, as such term is defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841); 1,200 persons.

*   *   *

(c)   *   *   *

(2) All securities of such class are held of record by fewer than 300 persons, or in the case of a bank; a savings and loan holding company, as such term is defined in section 10 of the Home Owners' Loan Act (12 U.S.C. 1461); or a bank holding company, as such term is defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841); 1,200 persons.

*   *   *   *   *

8. Amend § 240.12g-4 by revising paragraph (a) to read as follows:

§ 240.12g-4 Certifications of termination of registration under section 12(g).

(a) Termination of registration of a class of securities under section 12(g) of the Act (15 U.S.C. 78*l*(g)) shall take effect 90 days, or such shorter period as the Commission may determine, after the issuer certifies to the Commission on Form 15 (§ 249.323 of this chapter) that the class of securities is held of record by:

(1) Fewer than 300 persons;

(2) Fewer than 500 persons, where the total assets of the issuer have not exceeded $10 million on the last day of each of the issuer's most recent three fiscal years; or

(3) In the case of a bank; a savings and loan holding company, as such term is defined in section 10 of the Home Owners' Loan Act (12 U.S.C. 1461); or a bank holding company, as such term is defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841); fewer than 1,200 persons.

* * * * *

9. Amend § 240.12g5-1 by adding paragraph (a)(7) to read as follows:

§ 240.12g5-1 Definition of securities "held of record".

* * * * *

(a) * * *

(7)(i) For purposes of determining whether an issuer is required to register a class of equity securities with the Commission pursuant to section 12(g)(1) of the Act (15 U.S.C. 78*l*(g)(1)), an issuer may exclude securities:

(A) Held by persons who received the securities pursuant to an employee compensation plan in transactions;

(*1*) Exempt from the registration requirements of section 5 of the Securities Act of 1933 (15 U.S.C. 77e); or

(*2*) That did not involve a sale within the meaning of section 2(a)(3) of the Securities Act of 1933 (15 U.S.C. 77b(a)(3)); and

(B) Held by persons eligible to receive securities from the issuer pursuant to § 230.701(c) of this chapter who received the securities in a transaction exempt from the registration requirements of section 5 of the Securities Act (15 U.S.C. 77e) in exchange for securities excludable under this paragraph (a)(7).

(ii) As a non-exclusive safe harbor under this paragraph (a)(7), a person will be deemed to have received the securities pursuant to an employee compensation plan if such person received the securities pursuant to a compensatory benefit plan in transactions that meet the conditions of § 230.701(c) of this chapter.

10. Amend § 240.12h-3 by revising paragraph (b)(1) to read as follows:

§ 240.12h-3 Suspension of duty to file reports under section 15(d).

* * * * *

(b) * * *

(1) Any class of securities, other than any class of asset-backed securities, held of record by:

(i) Fewer than 300 persons;

(ii) Fewer than 500 persons, where the total assets of the issuer have not exceeded $10 million on the last day of each of the issuer's three most recent fiscal years; or

(iii) In the case of a bank; a savings and loan holding company, as such term is defined in section 10 of the Home Owners' Loan Act (12 U.S.C. 1461); or a bank holding company, as such term is defined in section 2 of the Bank Holding Company Act of 1956 (12 U.S.C. 1841); fewer than 1,200 persons; and

* * * * *

By the Commission.

Brent J. Fields
Secretary

December 17, 2014

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 232

[Release Nos. 33-9692; 34-73868; 39-2499; IC-31383]

Adoption of Updated EDGAR Filer Manual

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission (the Commission) is adopting revisions to the Electronic Data Gathering, Analysis, and Retrieval System (EDGAR) Filer Manual and related rules to reflect updates to the EDGAR system. The updates are being made primarily to make available a new exhibit type EX-1.01 and disallow Exhibit type EX-1.02 on EDGARLink Online for submission form types SD and SD/A, to implement the "Calendar Year Ending" value validation rule for form type 13H-A, to require Transfer Agents with file numbers in the range 085-15000 to 085-19999 to select "Comptroller of the Currency" as the registrant's appropriate regulatory agency on Form TA-2 and its amendment, and to update the EDGAR Portal to include a new option, "Do you need more information?" that links to the 'Guidance for Filers and FAQs' section on the SEC's Public Website (www.sec.gov). The EDGAR system is scheduled to be upgraded to support this functionality on December 15, 2014.

EFFECTIVE DATE: [Insert date of publication in the Federal Register.] The incorporation by reference of the EDGAR Filer Manual is approved by the Director of the Federal Register as of [Insert date of publication in the Federal Register].

FOR FURTHER INFORMATION CONTACT: In the Division of Corporation Finance, for questions concerning the revisions for Form SD or SD/A, contact Heather Mackintosh at (202) 551-3600; in the Division of Trading and Markets, for questions concerning the revisions for Form

13H-A and TA-2, contact Kathy Bateman at (202) 551-4345, and in the Office of Information Technology, contact Tammy Borkowski at (202) 551-7208.

SUPPLEMENTARY INFORMATION: We are adopting an updated EDGAR Filer Manual, Volume I and Volume II. The Filer Manual describes the technical formatting requirements for the preparation and submission of electronic filings through the EDGAR system.[1] It also describes the requirements for filing using EDGARLink Online and the Online Forms/XML website.

The revisions to the Filer Manual reflect changes within Volume I entitled EDGAR Filer Manual, Volume I: "General Information," Version 19 (December 2014), and Volume II entitled EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 29 (December 2014). The updated manual will be incorporated by reference into the Code of Federal Regulations.

The Filer Manual contains all the technical specifications for filers to submit filings using the EDGAR system. Filers must comply with the applicable provisions of the Filer Manual in order to assure the timely acceptance and processing of filings made in electronic format.[2] Filers may consult the Filer Manual in conjunction with our rules governing mandated electronic filing when preparing documents for electronic submission.[3]

The EDGAR system will be upgraded to Release 14.3 on December 15, 2014 and will introduce the following changes.

A new exhibit type EX-1.01 will be available on EDGARLink Online for submission form types SD and SD/A. Filers that are filing a Conflict Minerals Report should specify Item 1.02 on

[1] We originally adopted the Filer Manual on April 1, 1993, with an effective date of April 26, 1993. Release No. 33-6986 (April 1, 1993) [58 FR 18638]. We implemented the most recent update to the Filer Manual on October 20, 2014. See Release No. 33-9668 (October 29, 2014) [79 FR 64311].

[2] See Rule 301 of Regulation S-T (17 CFR 232.301).

[3] See Release No. 33-9668 in which we implemented EDGAR Release 14.2. For additional history of Filer Manual rules, please see the cites therein.

a Form SD or SD/A submission and attach the Conflict Minerals Report as EX-1.01 in official ASCII or HTML format. Exhibit type EX-1.02, which was previously allowed on a SD and SD/A submission, will no longer be available on EDGARLink Online or accepted by EDGAR.

Submission form type 13H-A will restrict the "Calendar Year Ending" value to a year that is prior to the current calendar year.

The EDGAR automated submission notification email for a 13H-A submission form type will inform the filer that the 13H-A submission received was for an annual filing or a combined annual and fourth quarter filing.

Form TA-2 and its amendment will be updated to remove "Office of Thrift Supervision" as an option for Item 3(a) – Registrant's appropriate regulatory agency (ARA). Filers must download the latest template to file Form TA-2 and its amendment using the 'EDGARLite Submission Templates' link on the EDGAR OnlineForms Management Website.

Transfer Agents with file numbers in the range 085-15000 to 085-19999 must now select "Comptroller of the Currency" instead of "Office of Thrift Supervision" as the registrant's appropriate regulatory agency on Form TA-2 and its amendment. In addition, EDGAR will suspend filer-constructed submissions of Form TA-2 and its amendment with "Office of Thrift Supervision" (OTS) as the value for the registrant's appropriate regulatory agency. Please refer to the "EDGAR Form TA-2 Technical Specification" document for details.

Validations for Item 5 of Form TA-2 and its amendment will be updated as follows. If the response for Item 2(a) is "Some" or "None" and the value for Item 5(a) is equal to zero, then the total of Items 5d(i) to 5d(vi) must be equal to 0%; if it is greater than zero, then the total of Items 5d(i) to 5d(vi) must be equal to 100%.

The EDGAR automated submission notification emails for Form D submissions will include the web address of the Electronic Filing Depository (https://efdnasaa.org) to enable Form D filers fulfill their state filing obligations.

The EDGAR Portal will be updated to include a new option, "Do you need more information?" that links to the 'Guidance for Filers and FAQs' section on the SEC's Public Website (www.sec.gov). In addition, the 'Access Notes' section on the EDGAR Portal will include contact information for EDGAR Filer Support.

Along with the adoption of the Filer Manual, we are amending Rule 301 of Regulation S-T to provide for the incorporation by reference into the Code of Federal Regulations of today's revisions. This incorporation by reference was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51.

The updated EDGAR Filer Manual will be available for Web site viewing and printing; the address for the Filer Manual is http://www.sec.gov/info/edgar.shtml. You may also obtain paper copies of the EDGAR Filer Manual from the following address: Public Reference Room, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m.

Since the Filer Manual and the corresponding rule changes relate solely to agency procedures or practice, publication for notice and comment is not required under the Administrative Procedure Act (APA).[4] It follows that the requirements of the Regulatory Flexibility Act[5] do not apply.

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[4] 5 U.S.C. 553(b).

[5] 5 U.S.C. 601 - 612.

The effective date for the updated Filer Manual and the rule amendments is [Insert date of publication in the Federal Register]. In accordance with the APA,[6] we find that there is good cause to establish an effective date less than 30 days after publication of these rules. The EDGAR system upgrade to Release 14.3 is scheduled to become available on December 15, 2014. The Commission believes that establishing an effective date less than 30 days after publication of these rules is necessary to coordinate the effectiveness of the updated Filer Manual with the system upgrade.

Statutory Basis

We are adopting the amendments to Regulation S-T under Sections 6, 7, 8, 10, and 19(a) of the Securities Act of 1933,[7] Sections 3, 12, 13, 14, 15, 23, and 35A of the Securities Exchange Act of 1934,[8] Section 319 of the Trust Indenture Act of 1939,[9] and Sections 8, 30, 31, and 38 of the Investment Company Act of 1940.[10]

List of Subjects in 17 CFR Part 232

Incorporation by reference, Reporting and recordkeeping requirements, Securities.

TEXT OF THE AMENDMENT

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

PART 232 - REGULATION S-T—GENERAL RULES AND REGULATIONS FOR ELECTRONIC FILINGS

[6] 5 U.S.C. 553(d)(3).

[7] 15 U.S.C. 77f, 77g, 77h, 77j, and 77s(a).

[8] 15 U.S.C. 78c, 78l, 78m, 78n, 78o, 78w, and 78ll.

[9] 15 U.S.C. 77sss.

[10] 15 U.S.C. 80a-8, 80a-29, 80a-30, and 80a-37.

1. The authority citation for Part 232 continues to read in part as follows:

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s(a), 77z–3, 77sss(a), 78c(b), 78l, 78m, 78n, 78o(d), 78w(a), 78ll, 80a–6(c), 80a–8, 80a–29, 80a–30, 80a–37, and 7201 et seq.; and 18 U.S.C. 1350.

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2. Section 232.301 is revised to read as follows:

§232.301 EDGAR Filer Manual.

Filers must prepare electronic filings in the manner prescribed by the EDGAR Filer Manual, promulgated by the Commission, which sets out the technical formatting requirements for electronic submissions. The requirements for becoming an EDGAR Filer and updating company data are set forth in the updated EDGAR Filer Manual, Volume I: "General Information," Version 19 (December 2014). The requirements for filing on EDGAR are set forth in the updated EDGAR Filer Manual, Volume II: "EDGAR Filing," Version 29 (December 2014). Additional provisions applicable to Form N-SAR filers are set forth in the EDGAR Filer Manual, Volume III: "N-SAR Supplement," Version 4 (October 2014). All of these provisions have been incorporated by reference into the Code of Federal Regulations, which action was approved by the Director of the Federal Register in accordance with 5 U.S.C. 552(a) and 1 CFR Part 51. You must comply with these requirements in order for documents to be timely received and accepted. The EDGAR Filer Manual is available for Web site viewing and printing; the address for the Filer Manual is http://www.sec.gov/info/edgar.shtml. You can obtain paper copies of the EDGAR Filer Manual from the following address: Public Reference Room, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. You can also inspect the document at the National Archives and Records

Administration (NARA). For information on the availability of this material at NARA, call 202–741–6030, or go to:

http://www.archives.gov/federal_register/code_of_federal_regulations/ibr_locations.html.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

December 17, 2014

SECURITIES AND EXCHANGE COMMISSION

17 CFR Part 275

Release No. IA-3984; File No. S7-23-07

RIN 3235-AL56

Temporary Rule Regarding Principal Trades With Certain Advisory Clients

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is amending rule 206(3)-3T under the Investment Advisers Act of 1940, a temporary rule that establishes an alternative means for investment advisers that are registered with the Commission as broker-dealers to meet the requirements of section 206(3) of the Investment Advisers Act when they act in a principal capacity in transactions with certain of their advisory clients. The amendment extends the date on which rule 206(3)-3T will sunset from December 31, 2014 to December 31, 2016.

DATES: The amendments in this document are effective December 30, 2014 and the expiration date for 17 CFR 275.206(3)-3T is extended to December 31, 2016.

FOR FURTHER INFORMATION CONTACT: Melissa S. Gainor, Senior Counsel, Sarah A. Buescher, Branch Chief, or Daniel S. Kahl, Assistant Director, at (202) 551-6787 or *IArules@sec.gov*, Investment Adviser Regulation Office, Division of Investment Management, U.S. Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-8549.

SUPPLEMENTARY INFORMATION: The Securities and Exchange Commission is adopting an amendment to temporary rule 206(3)-3T [17 CFR 275.206(3)-3T] under the Investment Advisers Act of 1940 [15 U.S.C. 80b] that extends the date on which the rule will sunset from December 31, 2014 to December 31, 2016.

I. Background

On September 24, 2007, we adopted, on an interim final basis, rule 206(3)-3T, a temporary rule under the Investment Advisers Act of 1940 (the "Advisers Act") that provides an alternative means for investment advisers that are registered with us as broker-dealers to meet the requirements of section 206(3) of the Advisers Act when they act in a principal capacity in transactions with certain of their advisory clients.[1] The purpose of the rule was to permit broker-dealers to sell to their non-discretionary advisory clients, following the decision in *Financial Planning Association v. SEC*,[2] certain securities held in the proprietary accounts of their firms that might not be available on an agency basis, or might be available on an agency basis only on less attractive terms, while protecting clients from conflicts of interest as a result of such transactions.[3] In December 2009, we adopted rule 206(3)-3T as a final rule in the same form in which it was adopted on an interim final basis in 2007, except that we extended the rule's sunset date by one year to December 31, 2010.[4] We deferred final action on rule 206(3)-3T in December 2009 because we needed additional time to understand how, and in what situations, the rule was being used.[5] In both December 2010 and December 2012, we further extended the rule's sunset date, in each case for an additional two-year period.[6] We deferred final action on

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1 Rule 206(3)-3T [17 CFR 275.206(3)-3T]. All references to rule 206(3)-3T and the various sections thereof in this release are to 17 CFR 275.206(3)-3T and its corresponding sections. *See also Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2653 (Sep. 24, 2007) [72 FR 55022 (Sep. 28, 2007)] ("2007 Principal Trade Rule Release").

2 482 F.3d 481 (D.C. Cir. 2007) (vacating rule 202(a)(11)-1 under the Advisers Act).

3 *See* 2007 Principal Trade Rule Release, Sections I and VI.C.

4 *See Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2965 (Dec. 23, 2009) [74 FR 69009 (Dec. 30, 2009)] ("2009 Extension Release"); *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 2965A (Dec. 31, 2009) [75 FR 742 (Jan. 6, 2010)] (making a technical correction to the 2009 Extension Release).

5 *See* 2009 Extension Release, Section II.c.

6 *See Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 3118 (Dec. 1, 2010) [75 FR 75650 (Dec. 6, 2010)] (proposing a two-year extension of rule

rule 206(3)-3T in 2010 in order to complete a study required by section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act").[7] In 2012, we deferred final action on rule 206(3)-3T to further consider the findings, conclusions, and recommendations of the 913 Study and the comments we had received from interested parties.[8] In connection with each extension, we noted that our consideration of the regulatory requirements applicable to broker-dealers and investment advisers was ongoing and that an extension would allow the Commission to consider more broadly the regulatory requirements applicable to broker-dealers and investment advisers, including whether rule 206(3)-3T should be substantively modified, supplanted, or permitted to sunset.[9]

We have continued to consider the regulatory requirements applicable to broker-dealers and investment advisers. In 2013, we issued a request for data and other information, including

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206(3)-3T's sunset provision) ("2010 Extension Proposing Release"); *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 3128 (Dec. 28, 2010) [75 FR 82236 (Dec. 30, 2010)] (extending rule 206(3)-3T's sunset provision from December 31, 2010 to December 31, 2012) ("2010 Extension Release"); *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 3483 (Oct. 9, 2012) [77 FR 62185 (Oct. 12, 2012)] (proposing a two-year extension of rule 206(3)-3T's sunset provision); *Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 3522 (Dec. 20, 2012) [77 FR 76854 (Dec. 31, 2012)] (extending rule 206(3)-3T's sunset provision from December 31, 2012 to December 31, 2014) ("2012 Extension Release").

7 Public Law 111-203, 124 Stat. 1376 (2010). Under section 913 of the Dodd-Frank Act, we were required to conduct a study and provide a report to Congress concerning the obligations of broker-dealers and investment advisers, including standards of care applicable to those intermediaries and their associated persons. Section 913 also authorizes us to promulgate rules concerning the legal or regulatory standards of care for broker-dealers, investment advisers, and persons associated with these intermediaries for providing personalized investment advice about securities to retail customers, taking into account the findings, conclusions, and recommendations of the study.

The study mandated by section 913 of the Dodd-Frank Act was prepared by the staff and delivered to Congress on January 21, 2011. *See Study on Investment Advisers and Broker-Dealers* ("913 Study") (Jan. 21, 2011), available at *http://www.sec.gov/news/studies/2011/913studyfinal.pdf*. For a discussion regarding principal trading, *see* section IV.C.1.(b) of the 913 Study. *See also* Commissioners Kathleen L. Casey and Troy A. Paredes, *Statement by SEC Commissioners: Statement Regarding Study on Investment Advisers and Broker-Dealers* (Jan. 21, 2011), available at *http://www.sec.gov/news/speech/2011/spch012211klctap.htm* (opposing the release of the 913 Study to Congress and stating that more rigorous analysis is required before the Commission engages in any follow-on rulemaking).

8 *See* 2012 Extension Release, Section II.

9 *See id.*; 2010 Extension Release, Section II.

quantitative data and economic analysis, relating to the benefits and costs that could result from alternative approaches regarding the standards of conduct and other obligations of broker-dealers and investment advisers.[10] The staff has received over 200 comment letters in response to the Request, several of which discussed rule 206(3)-3T, and Commissioners and the staff have held numerous meetings with interested parties.[11]

On August 12, 2014, we proposed to extend the date on which rule 206(3)-3T will sunset for a limited amount of time, from December 31, 2014 to December 31, 2016.[12] We received nine comment letters addressing our proposal.[13] Seven of these commenters generally supported extending rule 206(3)-3T for at least two years,[14] while two commenters opposed a two-year extension.[15] The comments we received on our proposal are discussed below. After considering each of the comments, we are extending the rule's sunset date by two years to December 31, 2016, as proposed.

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10 *Duties of Brokers, Dealers, and Investment Advisers*, Investment Advisers Act Release No. 3558 (Mar. 1, 2013) [78 FR 14848 (Mar. 7, 2013)] (the "Request").

11 *See Comments on Study Regarding Obligations of Brokers, Dealers, and Investment Advisers*, File No. 4-606, available at *http://sec.gov/comments/4-606/4-606.shtml*. *See e.g.*, Comment Letter of North American Securities Administrators Association, Inc. (Jul. 5, 2013) ("[T]he Commission should consider SEC Rule 206(3)-3T as part of future fiduciary standard rulemaking.").

12 *See Temporary Rule Regarding Principal Trades with Certain Advisory Clients*, Investment Advisers Act Release No. 3893 (Aug. 12, 2014), [79 FR 48709 (Aug. 18, 2014)] ("Proposing Release").

13 *See* Comment Letter of Chris Barnard (Aug. 22, 2014) ("Barnard Letter"); Comment Letter of Better Markets, Inc. (Sept. 17, 2014) ("Better Markets Letter"); Comment Letter of Consumer Federation of America (Sept. 17, 2014) ("Consumer Federation Letter"); Comment Letter of Financial Services Institute (Sept. 17, 2014) ("FSI Letter"); Comment Letter of Financial Services Roundtable (Sept. 16, 2014) ("FSR Letter"); Comment Letter of Jeffrey W. Lynn (Aug. 24, 2014) ("Lynn Letter"); Comment Letter of Thomas Michael Manis (Aug. 21, 2014) ("Manis Letter"); Comment Letter of Securities Industry and Financial Markets Association ("SIFMA") (Sept. 17, 2014) ("SIFMA 2014 Letter"); Comment Letter of Wells Fargo Advisors, LLC (Sept. 17, 2014) ("Wells Fargo Letter"). We received one comment letter that did not directly address the issues in the proposal. *See* Comment Letter of J. Wayne-Lynn (Sept. 3, 2014). We also received one comment letter discussing Title IX of the Dodd-Frank Act (including section 913), but not specifically addressing the extension of the rule or principal trading. *See* Comment Letter of Norman B. Arnoff, Esq. and Paul A. Immerman, Esq. (Oct. 26, 2014).

14 *See* Barnard Letter; FSI Letter; FSR Letter; Lynn Letter; Manis Letter; SIFMA 2014 Letter; Wells Fargo Letter.

15 *See* Better Markets Letter; Consumer Federation Letter.

II. Discussion

We are amending rule 206(3)-3T only to extend the rule's sunset date by two additional years.[16] We are not adopting any substantive amendments to the rule at this time. Absent further action by the Commission, the rule would sunset on December 31, 2014. We are adopting this extension because, as we discussed in the Proposing Release, we continue to believe that the issues raised by principal trading, including the restrictions in section 206(3) of the Advisers Act and our experiences with, and observations regarding, the operation of rule 206(3)-3T, should be considered as part of our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers in connection with the Dodd-Frank Act.[17]

Section 913 of the Dodd-Frank Act authorizes us to promulgate rules concerning, among other things, the legal or regulatory standards of conduct for broker-dealers, investment advisers, and persons associated with these intermediaries when providing personalized investment advice about securities to retail customers. Since the completion of the 913 Study in 2011, we have been considering the findings, conclusions, and recommendations of the study and the comments we have received from interested parties.[18] The Commission and its staff have continued to

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16 The rule includes a reference to an "investment grade debt security," which is defined as "a non-convertible debt security that, at the time of sale, is rated in one of the four highest rating categories of at least two nationally recognized statistical rating organizations (as defined in section 3(a)(62) of the Exchange Act)." Rule 206(3)-3T(a)(2) and (c). Section 939A of the Dodd-Frank Act requires that we "review any regulation issued by [us] that requires the use of an assessment of the credit-worthiness of a security or money market instrument; and any references to or requirements in such regulations regarding credit ratings." Once we have completed that review, the statute provides that we modify any regulations identified in our review to "remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness" as we determine appropriate. We believe that the credit rating requirement in the temporary rule would be better addressed after the Commission completes its review of the regulatory standards of conduct that apply to broker-dealers and investment advisers. *See generally Report on Review of Reliance on Credit Ratings* (July 21, 2011), available at *http://www.sec.gov/news/studies/2011/939astudy.pdf* (staff study reviewing the use of credit ratings in Commission regulations).

17 *See* Proposing Release, Section II.

18 Section 913(f) of the Dodd-Frank Act requires us to consider the 913 Study in any rulemaking authorized by that section of the Dodd-Frank Act. *See also Comments on Study Regarding Obligations of Brokers, Dealers, and Investment Advisers*, File No. 4-606, available at *http://sec.gov/comments/4-606/4-606.shtml*.

evaluate options regarding regulatory requirements applicable to broker-dealers and investment advisers, taking into account the 913 Study's recommendations, the views of investors and other interested market participants, potential economic and market impacts, and the information we received in response to the Request. Staff has also been conducting examinations of dual registrants and is assessing the impact to investors of the different supervisory structures and legal standards of conduct that govern the provision of brokerage and investment advisory services, which may help inform our considerations.[19] Our consideration of the regulatory requirements applicable to broker-dealers and investment advisers is ongoing. We will not complete our consideration of these issues before December 31, 2014, the current sunset date for rule 206(3)-3T.

If we permit rule 206(3)-3T to sunset on December 31, 2014, after that date investment advisers registered with us as broker-dealers that currently rely on rule 206(3)-3T would be required to comply with section 206(3)'s transaction-by-transaction written disclosure and consent requirements without the benefit of the alternative means of complying with these requirements provided by rule 206(3)-3T if they want to engage in principal trades with non-discretionary advisory account clients. This could limit the access of non-discretionary advisory clients of advisory firms that are registered with us as broker-dealers to certain securities.[20] In addition, firms may be required to make substantial changes to their disclosure documents, client agreements, procedures, and systems.

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19 *See* National Exam Program, Office of Compliance Inspections and Examinations, *Examination Priorities for 2014* (Jan. 9, 2014), available at *http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2014.pdf*.

20 For a discussion of the costs and benefits underlying rule 206(3)-3T, *see* 2007 Principal Trade Rule Release, Section VI.C.

As noted above, seven commenters generally supported our proposal to extend rule 206(3)-3T, and two commenters opposed the two-year extension. Commenters who supported the extension cited the disruption to investors that would occur if the rule expired at this time, asserting that investors would lose access to the securities currently offered through principal trades, receive less favorable pricing on such securities, or be forced to open brokerage accounts if they wished to maintain access to certain securities only available on a principal basis.[21] Two commenters also stated that the expiration of rule 206(3)-3T would reduce execution quality for non-discretionary advisory account clients who would no longer have access to a firm's principal accounts.[22] Some commenters further explained that, if the rule were allowed to expire, firms relying on the rule would be required to make considerable changes to their operations, client relationships, systems, policies and procedures at substantial expense, without substantial benefits to investors.[23]

Commenters supporting the extension agreed that extending the rule while the Commission conducted its review of the obligations of broker-dealers and investment advisers would be the least disruptive option.[24] However, several of these commenters questioned whether a two-year extension provided the Commission with sufficient time to complete its review and to engage in any subsequent Commission action.[25] These commenters recommended

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21 *See e.g.*, FSR Letter (asserting that "investors would be harmed" if the rule were allowed to expire because investors would have limited access to certain securities); SIFMA 2014 Letter (noting that the rule benefits investors by "allowing firms to offer investors a greater variety of securities from firm inventories, execute trades in such securities more quickly, and offer customers better prices on such securities"); Wells Fargo Letter (arguing that the expiration of rule 206(3)-3T would "limit investor choice, negatively impact pricing and force clients to incur additional expenses to access the wider range of securities available through principal trading").

22 *See* FSR Letter; Wells Fargo Letter.

23 *See* FSI Letter; FSR Letter; SIFMA 2014 Letter; Wells Fargo Letter.

24 *See* Barnard Letter; FSI Letter; FSR Letter; SIFMA 2014 Letter; Wells Fargo Letter.

25 *See* FSR Letter; SIFMA 2014 Letter; Wells Fargo Letter.

that the Commission adopt rule 206(3)-3T on a permanent basis or, at a minimum, that the Commission extend the rule for five years.[26] Some commenters suggested that adopting the rule on a permanent basis or adopting a longer extension of the rule would also have the benefit of reducing uncertainty for investors and dual-registrant firms.[27]

Three commenters specifically addressed Commission consideration of requests for exemptive orders as an alternative means of compliance with section 206(3). These commenters strongly supported extending the rule instead of Commission consideration of requests for exemptive orders.[28] Two commenters expressed concern about the potential inefficiency and uncertainty created by the need to submit individual requests for exemptive relief, and suggested that the Commission consider a request for class exemptive relief if the rule were allowed to sunset.[29] One commenter urged the Commission to adopt a streamlined process for exemptive requests that closely tracks the procedures of the rule if the rule sunsets.[30]

Two commenters opposed extending the rule, arguing that the Commission should not premise an extension of the rule on the need to consider principal trading as part of the broader consideration of the obligations of broker-dealers and investment advisers when the Commission has not yet commenced any formal rulemaking under section 913 of the Dodd-Frank Act.[31] These commenters questioned whether the temporary rule provides adequate investor protection

26 *See* FSR Letter; SIFMA 2014 Letter; Wells Fargo Letter. *See also* FSI Letter (recommending that the Commission adopt rule 206(3)-3T on a permanent basis as part of a harmonization of the regulatory requirements applicable to broker-dealers and investment advisers); Lynn Letter (questioning the temporary nature of the rule).

27 *See* FSR Letter; SIFMA 2014 Letter.

28 *See* FSR Letter; SIFMA 2014 Letter; Wells Fargo Letter.

29 *See* FSR Letter; SIFMA 2014 Letter.

30 *See* Wells Fargo Letter.

31 *See* Better Markets Letter; Consumer Federation Letter.

against abusive trading practices.[32] In this regard, the commenters asserted that oral disclosure and consent may not promote informed investor decisions in light of the limitations of such disclosures.[33] In addition, the commenters argued that there is no evidence that principal trades being conducted in accordance with the rule are being conducted in investors' best interests.[34] One commenter also questioned whether the Commission had considered evidence that had emerged since the rule was first adopted in connection with the proposed extension.[35]

On balance, and after careful consideration of these comments, we conclude that extending the rule for two years is the most appropriate course of action at this time. First, with respect to investors, we agree with those commenters that supported extending the rule that permitting the rule to sunset before we complete our consideration of the regulatory requirements applicable to broker-dealers and investment advisers could produce substantial disruption for investors with advisory accounts serviced by firms relying on the rule.[36] These investors might lose access to securities available through principal transactions and be forced to convert their accounts in the interim, only to face the possibility of future change — and the costs and uncertainty such additional change may entail.[37] We believe that rule 206(3)-3T benefits

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32 *See* Better Markets Letter (discussing conflicts associated with principal trading and stating that "it is likely that investors are often unaware of instances where principal trades with their brokers have caused harm, and these abuses go undetected"); Consumer Federation Letter (stating that today's market realities present "more, and more complex, opportunities for principal trading abuses" than dumping alone and suggesting that the Commission should update its understanding of these risks).

33 *See* Better Markets Letter ("A client certainly will have an easier time deciding whether or not to participate in the principal transaction if it receives the details of the proposed trade in writing, rather than having heard them once orally."); Consumer Federation Letter (arguing that the temporary rule "reflects an over-reliance on disclosure and fails to incorporate adequate measures to prevent principal trading abuses").

34 *See id.*

35 *See* Consumer Federation Letter.

36 *See* FSI Letter; FSR Letter; SIFMA 2014 Letter; Wells Fargo Letter.

37 As previously discussed in prior releases, firms have explained that they may refrain from engaging in principal trading with their advisory clients in the absence of the rule given the practical difficulties of complying with section 206(3), and thus may not offer principal trades through advisory accounts. *See,*

investors because it provides them with greater access to a wider range of securities and includes provisions designed to protect non-discretionary advisory clients.[38]

We do not agree with commenters who suggest that the rule places undue reliance on disclosure and consent, particularly oral disclosure and consent, as a means of investor protection.[39] Section 206(3) does not prohibit advisers from engaging in principal transactions, but rather prescribes a means by which an adviser must disclose and obtain the consent of its clients to the conflicts of interest involved.[40] In light of these serious conflicts of interest and a substantial risk that the proprietary interests of the adviser will prevail over those of its clients, rule 206(3)-3T provides advisers an alternative means to comply with the requirements of that section that is consistent with the purposes, and our prior interpretations of, section 206(3). The rule continues to provide the protection of transaction-by-transaction disclosure and consent, either orally or in writing, subject to several additional conditions designed to protect investors.[41] For example, the rule requires an adviser to provide written, prospective disclosure regarding the conflicts arising from principal trades and to obtain written, revocable consent from the client

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e.g., 2007 Principal Trade Rule Release, Section I.B; 2009 Extension Release, Section I; 2010 Extension Release, Section II. *See also* SIFMA 2014 Letter.

38 Several commenters agreed that an extension of the rule would continue to benefit investors. *See* SIFMA 2014 Letter ("If the Rule were allowed to expire, most firms continue to report that they would in most cases be unable to comply with Section 206(3) of the Advisers Act . . . Thus, firms would be required to eliminate or greatly reduce their offering of principal trades through advisory accounts, to the detriment of investors."); Wells Fargo Letter ("If [rule 206(3)-3T] sunsets on December 31, 2014, our clients who rely upon it will likely have access to a more limited universe of principal securities likely at higher prices."). *But see* Better Markets Letter (contending that the Commission does not have the authority to promulgate the rule, in part, because it cannot make the necessary findings under section 206A). We disagree with this commenter. For the reasons stated in this release we continue to believe that the rule extension is necessary and appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Advisers Act.

39 *See* Better Markets Letter; Consumer Federation Letter.

40 In particular, section 206(3) requires an adviser acting as principal for its own account to disclose to an advisory client in writing before the completion of the transaction the capacity in which the adviser is acting and obtain the consent of the client to such transaction.

41 *See* 2007 Principal Trade Rule Release, Section II.B. (expressing the belief that trade-by-trade disclosure and consent "continues to be important to alert clients to the potential for conflicted advice they may be receiving on individual transactions").

prospectively authorizing the adviser to enter into principal transactions. An adviser is also required under rule 206(3)-3T to send a confirmation statement to the client for each principal trade, disclosing the capacity in which the adviser has acted and indicating that the client consented to the transaction. The written confirmation statement serves as a reminder to clients of each transaction that the adviser effects on a principal basis and that conflicts of interest are inherent in such transactions.[42] In addition, the rule requires an adviser to deliver to the client an annual report itemizing principal transactions to ensure that clients receive a periodic record of principal trading activity in their accounts and to afford them the opportunity to assess the frequency with which their adviser engages in such trades.[43]

Moreover, we note that the rule is limited to principal trades with non-discretionary advisory account clients.[44] As previously stated, we are of the view that the risk of relaxing the procedural requirements of section 206(3) of the Advisers Act when a client has ceded substantial, if not complete, control over the account raises significant risks that the client will not be, or is not in a position to be, sufficiently involved in the management of the account to protect himself or herself from overreaching by the adviser.[45]

We believe that the requirements of rule 206(3)-3T, coupled with regulatory oversight, will adequately protect non-discretionary advisory clients for an additional limited period of time while we consider more broadly the regulatory requirements applicable to broker-dealers and

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42 *See* 2007 Principal Trade Rule Release, Section II.B.

43 *See id.*

44 Specifically, rule 206(3)-3T applies to principal trades with respect to accounts over which the client has not granted investment discretion, "except investment discretion granted by the advisory client on a temporary or limited basis." Rule 206(3)-3T(a)(1).

45 *See* 2007 Principal Trade Rule Release, Section II.B.

investment advisers.[46] Since its adoption and throughout the period of the extension, the staff has examined and will continue to examine firms that engage in principal transactions and will take appropriate action to help ensure that firms are complying with section 206(3) or rule 206(3)-3T (as applicable), including possible enforcement action.[47] Several recent cases demonstrate our commitment to enforcing firms' compliance with these requirements when they engage in principal transactions with clients.[48] As noted above, staff has also been conducting examinations of dual registrants and is assessing the impact to investors of the different supervisory structures and legal standards of conduct that govern the provision of brokerage and investment advisory services, which may help inform our considerations.[49]

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46 In addition, rule 206(3)-3T(b) provides that the rule does not relieve an investment adviser from acting in the best interests of its clients, or from any obligation that may be imposed by sections 206(1) or (2) of the Advisers Act or any other applicable provisions of the federal securities laws. Further, the rule requires that advisers seeking to rely on the rule also be registered with the Commission as broker-dealers and that each account for which the investment adviser relies on this rule be a brokerage account subject to the Exchange Act, and the rules thereunder, and the rules of the self-regulatory organization(s) of which the broker-dealer is a member. Rule 206(3)-3T(a)(7).

47 In the 2010 Extension Proposing Release, we discussed certain compliance issues identified by the Office of Compliance Inspections and Examinations. *See* 2010 Extension Proposing Release, Section II. One matter identified in the staff's review resulted in a settlement of an enforcement proceeding and other matters continue to be reviewed by the staff. *See In the Matter of Feltl & Company, Inc.*, Investment Advisers Act Release No. 3325 (Nov. 28, 2011) (settled order finding, among other things, violations of section 206(3) of the Advisers Act for certain principal transactions and section 206(4) of the Advisers Act and rule 206(4)-7 thereunder for failure to adopt written policies and procedures reasonably designed to prevent violations of the Advisers Act and its rules).

48 *See In the Matter of Barclays Capital Inc.*, Investment Advisers Act Release No. 3929 (Sept. 23, 2014) (settled order finding, among other things, violations of section 206(3) of the Advisers Act for engaging in transactions with advisory clients on a principal basis without providing prior written disclosure to, or obtaining consent from, the clients); *In the Matter of Strategic Capital Group LLC and N. Gary Price*, Investment Advisers Act Release No. 3924 (Sept. 18, 2014) (settled order finding, among other things, violations of section 206(3) of the Advisers Act for engaging in transactions with advisory clients on a principal basis through an affiliated broker-dealer, without providing prior written disclosure to, or obtaining consent from, the clients); *In the Matter of Dominick & Dominick LLC and Robert X. Reilly*, Investment Advisers Act Release No. 3881 (July 28, 2014) (settled order finding, among other things, violations of section 206(3) of the Advisers Act for engaging in transactions with advisory clients on a principal basis without obtaining client consent before completing the transactions); *In the Matter of Paradigm Capital Management, Inc. and Candace King Weir*, Investment Advisers Act Release No. 3857 (June 16, 2014) (settled order finding, among other things, violations of section 206(3) of the Advisers Act for engaging in principal transactions with a hedge fund client through an affiliated broker-dealer without providing effective disclosure to, or obtaining consent from, the fund).

49 *See supra* note 19 and accompanying text.

We have also obtained information regarding principal trading through other means. For example, as noted in the Proposing Release, examination staff also requested and received materials from a sample of dual registrants in 2014 to observe the use of the rule by these firms.[50] This examination showed that a number of the firms that were contacted by staff relied on the rule and that those firms had adopted written policies and procedures under rule 206(4)-7 that are designed to comply with the requirements of the temporary rule.[51] Based on the review, it appeared to the staff that the firms relying on the rule had processes in place for the purpose of effecting principal transactions in compliance with the requirements of the temporary rule.

We continue to believe, on balance, that the disruption of allowing the rule to expire is unwarranted as the Commission is engaging in a comprehensive review process that may ultimately produce different regulatory requirements.[52] This disruption will be avoided if the rule remains available while the staff and Commission continue to review and consider the regulatory requirements applicable to broker-dealers and investment advisers.

For the reasons discussed above, we believe that the rule's sunset date should be extended for a limited period of time.[53] That period of time must be long enough to permit us to consider any rulemaking prompted by our broader review of regulatory requirements applicable to investment advisers and broker-dealers. The Commission and its staff have continued to focus on evaluating options regarding regulatory requirements applicable to broker-dealers and

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50 Staff identified a representative sample set of dual registrants based on Form ADV data, including firm disclosures on Form ADV Part 2A, and requested materials from the firms that included compliance policies and procedures, sample disclosures, and data regarding the firm's principal transactions with advisory accounts.

51 17 CFR 275.206(4)-7. *See also* 2007 Principal Trade Rule Release (noting that an adviser relying on rule 206(3)-3T as an alternative means of complying with section 206(3) must have adopted and implemented written policies and procedures reasonably designed to comply with the requirements of the rule).

52 *See* FSI Letter; FSR Letter; SIFMA 2014 Letter; Wells Fargo Letter.

53 *See* Proposing Release, Section II.

investment advisers. That review is ongoing. We continue to believe that two years provides us sufficient time to act regarding our broader review, while also providing an appropriate balance that addresses commenters' concerns regarding non-discretionary advisory clients' continued access to certain securities and any new investor protection concerns that we may identify through our examination program or otherwise.

III. Certain Administrative Law Matters

The amendment to rule 206(3)-3T is effective on December 30, 2014. The Administrative Procedure Act generally requires that an agency publish a final rule in the Federal Register not less than 30 days before its effective date.[54] However, this requirement does not apply if the rule is a substantive rule which grants or recognizes an exemption or relieves a restriction, or if the rule is interpretive.[55] Rule 206(3)-3T is a rule that recognizes an exemption and relieves a restriction and in part has interpretive aspects.

IV. Paperwork Reduction Act

Rule 206(3)-3T contains "collection of information" requirements within the meaning of the Paperwork Reduction Act of 1995.[56] The Office of Management and Budget ("OMB") last approved the collection of information with an expiration date of July 31, 2017. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid OMB control number. The title for the collection of information is: "Temporary rule for principal trades with certain advisory clients, rule 206(3)-3T" and the OMB control number for the collection of information is 3235-0630. The Proposing

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54 5 U.S.C. 553(d).

55 *Id.*

56 44 U.S.C. 3501 et seq.

Release solicited comments on our PRA estimates, but we did not receive comment on them.[57]

The amendment to the rule we are adopting today – to extend rule 206(3)-3T's sunset date for two years – does not affect the current annual aggregate estimated hour burden of 139,358 hours.[58] Therefore, we are not revising the Paperwork Reduction Act burden and cost estimates submitted to OMB as a result of this amendment.

V. Economic Analysis

A. Introduction

The Commission is sensitive to the economic effects, including the benefits and costs and the effects on efficiency, competition, and capital formation, that will result from extending rule 206(3)-3T's sunset date for two years.[59] The economic effects considered in adopting this extension are discussed below.

Rule 206(3)-3T provides an alternative means for investment advisers that are registered with the Commission as broker-dealers to meet the requirements of section 206(3) of the Advisers Act when they act in a principal capacity in transactions with their non-discretionary advisory clients. Other than extending the rule's sunset date for two additional years, we are not modifying the rule from its current form. We are extending rule 206(3)-3T in its current form to avoid disruption to firms and clients that rely on the rule while the Commission continues its ongoing consideration of the regulatory requirements applicable to broker-dealers and investment advisers and the recommendations from the 913 Study. In particular, extending the

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57 *See* Proposing Release, Section IV.

58 *See Proposed Collection; Comment Request*, 78 FR 72932 (Dec. 4, 2013); *Submission for OMB Review; Comment Request*, 79 FR 7481 (Feb. 7, 2014).

59 15 U.S.C. 80b-2(c). Section 202(c) of the Advisers Act mandates that the Commission, when engaging in rulemaking that requires it to consider or determine whether an action is necessary or appropriate in the public interest, consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.

current rule will permit firms to continue to offer, and clients to have access to, certain securities on a principal basis without being required to restructure their operations and client relationships, adjust to a new set of rules, or abandon the operational systems established to comply with the current rule – potentially only to have to do so again when the rule expires or is modified, and once more if the Commission adopts a new approach to principal trading in connection with the broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers. We previously considered and discussed the economic effects of rule 206(3)-3T in its current form in the 2007 Principal Trade Rule Release, the 2009 Extension Release, the 2010 Extension Release, and the 2012 Extension Release.[60]

At the outset, the Commission notes that, where possible, it has sought to quantify the costs, benefits, and effects on efficiency, competition, and capital formation expected to result from extending rule 206(3)-3T and its reasonable alternatives. In many cases, however, the Commission is unable to quantify the economic effects because it lacks the information necessary to provide a reasonable estimate.[61] The staff has also not found other quantitative data, including through examinations and comment letters, which impacts the discussion of economic effects in previous releases. We will continue to assess the rule's operation and impacts along with intervening developments during the period of the extension.

The temporary rule currently in effect serves as the economic baseline against which the costs and benefits, as well as the impact on efficiency, competition, and capital formation, of the amendment are discussed. The amendment, which will extend rule 206(3)-3T's sunset date by

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60 *See* 2007 Principal Trade Rule Release, Sections VI-VII; 2009 Extension Release, Sections V-VI; 2010 Extension Release, Sections V-VI; 2012 Extension Release, Sections V-VI.

61 In previous releases, the Commission has requested comment on the economic effects of rule 206(3)-3T, the economic effects of extending the rule, and the economic effects of alternatives. The Commission has not received comments providing quantitative data regarding the economic effects of extensions of rule 206(3)-3T or to alternatives of the rule.

an additional two years, will affect investment advisers that are registered with the Commission as broker-dealers and engage in, or may consider engaging in, principal transactions with non-discretionary advisory clients, as well as the non-discretionary advisory clients of these firms that engage in, or may consider engaging in, principal transactions.

Based on IARD data as of October 1, 2014, there are 96 dual registrants that may be relying on the rule; however, evidence suggests that the number of firms actually relying on the rule may be smaller.[62] One commenter questioned whether the Commission could justify extending rule 206(3)-3T when it did not have specific data regarding dual registrant firms' reliance on the rule.[63] This commenter further suggested that without this and other data, the Commission could not confidently assert that the extension of the rule would have the economic effects set forth in the Proposing Release.[64] We know from current and past comment letters, as well as our examination findings, that both large and small advisers have relied and continue to rely upon the rule since its implementation in 2007.[65] Additionally, one comment letter to the Request provided survey results from a small sample of dual-registrant firms, showing that the

62 Based on IARD data as of October 1, 2014, there are 291 SEC-registered advisers that are also registered as broker-dealers that have non-discretionary accounts who could potentially rely on the rule; however, only 96 of these dual registrants indicate they currently engage in principal transactions on Form ADV. The actual number of advisers that engage in principal transactions in reliance on the temporary rule is likely smaller. The staff's recent outreach to observe the use of the rule by firms found that some of the dual registrants in the sample, which was derived based on Form ADV data, did not rely on the rule.

63 *See* Consumer Federation Letter.

64 *See id.*

65 *See* SIFMA 2014 Letter (stating that a significant number of SIFMA member firms continue to rely on rule 206(3)-3T); Wells Fargo Letter (noting that the firm managed approximately 275,000 non-discretionary advisory accounts in which hundreds of principal trades are made on a monthly basis for the benefit of investors). Past comment letters have also stated that dual registrant firms rely on the rule. For example, SIFMA's 2012 comment letter included survey results from seven dual-registrant firms that, in the aggregate, manage over $325 billion of assets in over 1.1 million non-discretionary advisory accounts. The firms indicated that 459,507 non-discretionary advisory accounts (with aggregate assets of over $125 billion) were eligible to engage in principal trading in reliance on the rule. These firms also indicated that, during 2010-2012, the firms engaged in principal trades in reliance on rule 206(3)-3T with respect to 106,682 accounts and executed an average of 12,009 principal trades per month in reliance on the rule. Comment Letter of SIFMA (Nov. 13, 2012).

firms engaged in a significant dollar amount of principal transactions in reliance on the rule in 2012.[66] We believe that this background information provides evidence indicating a reliance on the rule by certain dual-registrant firms. Because the economic effects of extending the rule and its reasonable alternatives will depend on the extent to which eligible firms rely on the rule to engage in principal transactions with non-discretionary advisory clients, however, we recognize that the economic effects could vary significantly among firms and their clients.

B. Analysis of the Extension and Alternatives

As noted above, the temporary rule currently in effect serves as the economic baseline against which the costs and benefits, as well as the impact on efficiency, competition, and capital formation, of the amendment are discussed. Because the extension of the sunset date in the temporary rule that we are adopting today maintains the status quo, we do not expect additional costs or benefits to result from the extension. For the same reason, we also do not expect the extension to have additional effects on efficiency, competition, or capital formation. Extending the current rule will provide the Commission with additional time to consider principal trading as part of the broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers.

Reasonable alternatives to extending the current rule that we considered include allowing the rule to expire, adopting the rule on a permanent basis, and extending the rule for a period other than two years. If the rule is allowed to expire, then an adviser that is registered as a broker-dealer would no longer have a lower cost and more efficient alternative to the

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66 *See* Comment Letter of SIFMA (Jul. 5, 2013). Ten firms responded to SIFMA's survey and reported that they relied on the temporary rule for $8 billion in principal transactions across 163,000 retail non-discretionary advisory accounts. In comparison, the ten firms engaged in $36 billion in principal transaction with 498,000 retail advisory accounts under section 206(3) of the Advisers Act and $809 billion in principal transactions with 2,480,000 retail brokerage accounts.

requirements under section 206(3) of the Advisers Act like that provided by the temporary rule,[67] and consequently non-discretionary advisory account clients could lose access to the principal accounts of firms that rely on the rule. As noted in the 2012 Extension Release, greater access to a wider range of securities may allow non-discretionary advisory clients to more efficiently allocate capital and, in the long term, the more efficient allocation of capital may lead to an increase in capital formation.[68] If the rule expires, the loss of access by non-discretionary advisory clients to a wider range of securities would reduce the ability of these investors to efficiently allocate capital. A decrease in the ability of investors to efficiently allocate capital could reduce any resulting long-term gains to capital formation. Allowing the rule to expire also would reduce the ability of investors to choose between brokerage accounts and advisory accounts if the investor wishes to maintain access to securities held in firm principal accounts, and may force non-discretionary advisory account clients to bear the costs associated with transferring to brokerage accounts (or lose access to a firm's principal accounts). Firms may also bear the potentially substantial costs associated with restructuring their operations and client relationships or seeking exemptive relief from the provisions of section 206(3) of the Advisers Act.

If the rule is allowed to expire, and firms engage in principal transactions with advisory account clients pursuant to the requirements of section 206(3) of the Advisers Act, investors may

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[67] Section 206(3) of the Advisers Act requires an investment adviser to provide written conflict-of-interest disclosure describing its role as principal when transacting securities from its own account and obtain client consent prior to transaction completion. Rule 206(3)-3T provides a dual registrant firm the option of providing transaction-by-transaction disclosures verbally instead of in writing when engaging in principal transactions with non-discretionary advisory clients as long as the firm satisfies additional requirements before and after the transactions. Additional requirements of the temporary rule include the provision of a written prospective disclosure to clients describing the conflicts arising from principal transactions, acquisition of written revocable client consent prospectively authorizing such transactions, the provision of transaction-by-transaction confirmations, and the provision of annual reports itemizing the clients' principal transactions thereafter.

[68] 2012 Extension Release, Section V.B.

be able to more fully evaluate the conflicts of the principal transactions at the time of trades. Two commenters who opposed the extension of rule 206(3)-3T questioned whether preserving investor access to securities sold on a principal basis is ultimately beneficial for investors given the presence of conflicts of interest and the potential for abuse including high trading costs.[69] We believe that the requirements of rule 206(3)-3T, coupled with regulatory oversight, will adequately protect non-discretionary advisory clients for the additional limited period of the extension. As noted above, section 206(3) does not prohibit advisers from engaging in principal transactions, but rather prescribes a means by which an adviser must disclose and obtain the consent of its clients to the conflicts of interest involved. Rule 206(3)-3T, which provides advisers an alternative means to comply with the requirements of that section, continues to provide the protection of transaction-by-transaction disclosure and consent, either orally or in writing, subject to several conditions, including: (i) Written, prospective disclosure regarding the conflicts arising from principal trades; (ii) written, revocable consent from the client prospectively authorizing the adviser to enter into principal transactions; (iii) a written confirmation statement sent to the client for each principal trade, disclosing the capacity in which the adviser has acted and indicating that the client consented to the transaction; and (iv) an annual report itemizing principal transactions. We also continue to believe that non-discretionary advisory client access to a wider range of securities is beneficial. Many clients wish to access securities held in the inventory of a diversified broker-dealer and clients may wish to access these securities through their non-discretionary advisory accounts.[70]

We previously received a comment suggesting that rule 206(3)-3T may impede capital formation because it would lead to "more numerous and more severe violations…of the trust

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69 *See* Better Markets Letter; Consumer Federation Letter.

70 *See* 2007 Principal Trade Rule Release, Section I.B.

placed by individual investors in their trusted investment adviser."[71] While we understand the view that numerous and severe violations of trust could impede capital formation, the staff has not identified instances where an adviser has used the temporary rule to "dump" unmarketable securities or securities that the adviser believes may decline in value into an advisory account, a harm that section 206(3) and the conditions and limitations of rule 206(3)-3T are designed to redress.[72] In addition, non-discretionary advisory account clients benefit from the protections of sales practice rules under the Securities Exchange Act of 1934 (the "Exchange Act") and of relevant self-regulatory organizations, and the fiduciary duty and other obligations imposed by the Advisers Act.

We also previously received comments opposing the limitation of the temporary rule to investment advisers that are registered with us as broker-dealers, as well as to accounts that are subject to both the Advisers Act and Exchange Act as providing a competitive advantage to investment advisers that are registered with us as broker-dealers.[73] Commenters on the Proposing Release did not address this specific issue and we have no reason to believe that broker-dealers (or affiliated but separate investment advisers and broker-dealers) are put at a competitive disadvantage to advisers that are themselves also registered as broker-dealers.[74] We intend to continue to evaluate the effects of the rule on efficiency, competition, and capital formation in connection with our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers.

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71 *See* Comment Letter of National Association of Personal Financial Advisors (Dec. 20, 2010).

72 *See* 2010 Extension Proposing Release, Section II (noting that the staff did not identify instances of "dumping" in connection with OCIE's examinations regarding compliance with the temporary rule).

73 *See* Comment Letter of the Financial Planning Association (Nov. 30, 2007); Comment Letter of the American Bar Association, section of Business Law's Committee on Federal Regulation of Securities (Apr. 18, 2008). *See also* 2009 Extension Release, Section VI.

74 *See* 2009 Extension Release, Section VI; 2010 Extension Release, Section VI; 2012 Extension Release, Section V.

If the Commission allowed the rule to expire, firms would no longer incur the costs associated with rule 206(3)-3T, including the operational costs associated with complying with the rule.[75] In the 2007 Principal Trade Rule Release, we presented estimates of the costs of each of the rule's disclosure elements, including: prospective disclosure and consent; transaction-by-transaction disclosure and consent; transaction-by-transaction confirmations; and the annual report of principal transactions. We also provided estimates for the following related costs of compliance with rule 206(3)-3T: (i) The initial distribution of prospective disclosure and collection of consents; (ii) systems programming costs to ensure that trade confirmations contain all of the information required by the rule; and (iii) systems programming costs to aggregate already-collected information to generate compliant principal transactions reports. We do not believe the extension we are adopting today affects the cost estimates associated with the rule.[76] Furthermore, we believe that an eligible adviser that begins to rely on rule 206(3)-3T today would bear the same types of upfront and ongoing costs discussed in the 2007 Principal Trade Rule Release.[77]

If the rule is adopted on a permanent basis, then there may be additional economic effects. We recognize that a temporary rule, by nature, creates uncertainty, which in turn, may result in a reduced ability of firms to coordinate and plan future business activities.[78] The uncertainty with respect to rule 206(3)-3T would be reduced if the rule was adopted on a

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75 *See supra* note 60.

76 In the 2007 Principal Trade Rule Release, we estimated the total overall costs, including estimated costs for all eligible advisers and eligible accounts, relating to compliance with rule 206(3)-3T to be $37,205,569. *See* 2007 Principal Trade Rule Release, Section VI.D.

77 *See id.*

78 *See* FSR Letter; SIFMA 2014 Letter; Wells Fargo Letter. We also received several comments in connection with prior extensions of the rule urging us to make the rule permanent to avoid such uncertainty. *See e.g.*, Comment Letter of Winslow, Evans & Crocker (Dec. 8, 2010); Comment Letter of Bank of America (Dec. 20, 2010).

permanent basis or if the rule was allowed to expire. Nonetheless, we believe that it would not be appropriate to adopt the rule on a permanent basis (with any necessary substantive amendments) while consideration of the regulatory requirements applicable to broker-dealers and investment advisers is ongoing.

Another alternative we considered was to extend the rule for a period other than two years. For example, extending the rule for greater than two years would provide the Commission with additional time to evaluate the impact of any potential rulemaking or other process that may emerge from the broader consideration of fiduciary obligations and other regulatory requirements applicable to broker-dealers and investment advisers. Should our consideration of the fiduciary obligations and other regulatory requirements applicable to broker-dealers and investment advisers extend beyond the sunset date of the temporary rule, such a longer period may be appropriate. Several commenters specifically stated that the rule should be extended for at least five years to provide the Commission with sufficient time to complete its review of the obligations of broker-dealers and investment advisers and to engage in any subsequent Commission action.[79] On balance, however, we continue to believe that the two-year extension of rule 206(3)-3T appropriately addresses the concerns of firms and clients relying on the rule while the Commission continues its ongoing consideration of the standards applicable to investment advisers and broker-dealers.

VI. Final Regulatory Flexibility Act Analysis

The Commission has prepared the following Final Regulatory Flexibility Analysis ("FRFA") regarding the amendment to rule 206(3)-3T in accordance with 5 U.S.C. 604. We prepared and included an Initial Regulatory Flexibility Analysis ("IRFA") in the Proposing

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[79] *See* FSR Letter; SIFMA 2014 Letter; Wells Fargo Letter.

Release.[80]

A. Need for the Rule Amendment

We are adopting an amendment to extend rule 206(3)-3T's sunset date for two years because we believe that it would not be appropriate to require firms relying on the rule to restructure their operations and client relationships before we complete our broader consideration of the regulatory requirements applicable to broker-dealers and investment advisers. The objective of the amendment to rule 206(3)-3T is to continue to provide an alternative method for investment advisers that are dually registered as broker-dealers to comply with section 206(3) of the Advisers Act when acting in a principal capacity with certain of their advisory clients. Absent further action by the Commission, the rule will sunset on December 31, 2014.

We are amending rule 206(3)-3T pursuant to sections 206A and 211(a) of the Advisers Act [15 U.S.C. 80b-6a and 15 U.S.C. 80b-11(a)].

B. Significant Issues Raised by Public Comments

We did not receive any comment letters related to our IRFA.

C. Small Entities Subject to the Rule

Rule 206(3)-3T is an alternative method of complying with Advisers Act section 206(3) and is available to all investment advisers that: (i) Are registered as broker-dealers under the Exchange Act; and (ii) effect trades with clients directly or indirectly through a broker-dealer controlling, controlled by or under common control with the investment adviser, including small entities. Under Advisers Act rule 0-7, for purposes of the Regulatory Flexibility Act an investment adviser generally is a small entity if it: (i) Has assets under management of less than $25 million; (ii) did not have total assets of $5 million or more on the last day of its most recent

80 *See* Proposing Release, Section VI.

fiscal year; and (iii) does not control, is not controlled by, and is not under common control with another investment adviser that has assets under management of $25 million or more, or any person (other than a natural person) that had total assets of $5 million or more on the last day of its most recent fiscal year.[81]

As noted in the Proposing Release, we estimated that as of June 1, 2014, 464 SEC-registered investment advisers were small entities.[82] As discussed in the 2007 Principal Trade Rule Release, we opted not to make the relief provided by rule 206(3)-3T available to all investment advisers, and instead have restricted it to investment advisers that also are registered as broker-dealers under the Exchange Act.[83] We therefore estimated for purposes of the IRFA that 12 of these small entities (those that are both investment advisers and registered broker-dealers) could rely on rule 206(3)-3T.[84] We did not receive any comments on these estimates.

D. Reporting, Recordkeeping, and other Compliance Requirements

The provisions of rule 206(3)-3T impose certain reporting or recordkeeping requirements and our amendment will extend the imposition of these requirements for an additional two years. The two-year extension will not alter these requirements.

Rule 206(3)-3T is designed to provide an alternative means of compliance with the requirements of section 206(3) of the Advisers Act. Investment advisers taking advantage of the rule with respect to non-discretionary advisory accounts are required to make certain disclosures to clients on a prospective, transaction-by-transaction and annual basis.

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81 *See* 17 CFR 275.0-7.

82 IARD data as of June 1, 2014. As of October 1, 2014, based on IARD data, we estimate that 480 SEC-registered investment advisers were small entities.

83 *See* 2007 Principal Trade Rule Release, Section VIII.B.

84 IARD data as of June 1, 2014. As of October 1, 2014, based on IARD data, we estimate that 7 of these small entities could rely on rule 206(3)-3T.

Specifically, rule 206(3)-3T permits an adviser, with respect to a non-discretionary advisory account, to comply with section 206(3) of the Advisers Act by, among other things: (i) Making certain written disclosures; (ii) obtaining written, revocable consent from the client prospectively authorizing the adviser to enter into principal trades; (iii) making oral or written disclosure and obtaining the client's consent orally or in writing prior to the execution of each principal transaction; (iv) sending to the client a confirmation statement for each principal trade that discloses the capacity in which the adviser has acted and indicating that the client consented to the transaction; and (v) delivering to the client an annual report itemizing the principal transactions. Advisers are already required to communicate the content of many of the disclosures pursuant to their fiduciary obligations to clients. Other disclosures are already required by rules applicable to broker-dealers.

Our amendment will only extend the rule's sunset date for two years in its current form. Advisers currently relying on the rule already should be making the disclosures described above.

E. Agency Action to Minimize Effect on Small Entities

The Regulatory Flexibility Act directs us to consider significant alternatives that would accomplish our stated objective, while minimizing any significant adverse impact on small entities.[85] Alternatives in this category would include: (i) Establishing different compliance or reporting standards or timetables that take into account the resources available to small entities; (ii) clarifying, consolidating, or simplifying compliance requirements under the rule for small entities; (iii) using performance rather than design standards; and (iv) exempting small entities from coverage of the rule, or any part of the rule.

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85 *See* 5 U.S.C. 603(c).

We believe that special compliance or reporting requirements or timetables for small entities, or an exemption from coverage for small entities, may create the risk that the investors who are advised by and effect securities transactions through such small entities would not receive adequate disclosure. Moreover, different disclosure requirements could create investor confusion if it creates the impression that small investment advisers have different conflicts of interest with their advisory clients in connection with principal trading than larger investment advisers. We believe, therefore, that it is important for the disclosure protections required by the rule to be provided to advisory clients by all advisers, not just those that are not considered small entities. Further consolidation or simplification of the proposals for investment advisers that are small entities would be inconsistent with our goal of fostering investor protection.

We have endeavored through rule 206(3)-3T to minimize the regulatory burden on all investment advisers eligible to rely on the rule, including small entities, while meeting our regulatory objectives. It was our goal to ensure that eligible small entities may benefit from our approach to the rule to the same degree as other eligible advisers. The condition that advisers seeking to rely on the rule must also be registered with us as broker-dealers and that each account with respect to which an adviser seeks to rely on the rule must be a brokerage account subject to the Exchange Act, and the rules thereunder, and the rules of the self-regulatory organization(s) of which the broker dealer is a member, reflect what we believe is an important element of our balancing between easing regulatory burdens (by affording advisers an alternative means of compliance with section 206(3) of the Act) and meeting our investor protection objectives.[86] Finally, we do not consider using performance rather than design standards to be consistent with our statutory mandate of investor protection in the present context.

86 *See* 2007 Principal Trade Rule Release, Section II.B.7 (noting commenters that objected to this condition as disadvantaging small broker-dealers (or affiliated but separate investment advisers and broker-dealers)).

VII. Statutory Authority

The Commission is amending rule 206(3)-3T pursuant to sections 206A and 211(a) of the Advisers Act [15 U.S.C. 80b-6a and 80b-11(a)].

LIST OF SUBJECTS IN 17 CFR PART 275

Investment advisers, Reporting and recordkeeping requirements.

TEXT OF RULE AMENDMENT

For the reasons set out in the preamble, Title 17, Chapter II of the Code of Federal Regulations is amended as follows.

PART 275 -- RULES AND REGULATIONS, INVESTMENT ADVISERS ACT OF 1940

1. The authority citation for Part 275 continues to read in part as follows:

Authority: 15 U.S.C. 80b-2(a)(11)(G), 80b-2(a)(11)(H), 80b-2(a)(17), 80b-3, 80b-4, 80b-4a, 80b-6(4), 80b-6a, and 80b-11, unless otherwise noted.

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§275.206(3)-3T [Amended]

2. In § 275.206(3)-3T, amend paragraph (d) by removing the words "December 31, 2014" and adding in their place "December 31, 2016."

By the Commission.

Brent J. Fields
Secretary

Dated: December, 17, 2014

Commissioner Piwowar
Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73869 / December 18, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16193

In the Matter of WebXU, Inc., Respondent.	**ORDER MAKING FINDINGS AND REVOKING REGISTRATION OF SECURITIES OF WEBXU PURSUANT TO SECTION 12(j) OF THE SECURITIES EXCHANGE ACT OF 1934**

I.

The Securities and Exchange Commission ("Commission") previously instituted proceedings in this matter on October 14, 2014. The Commission now deems it appropriate and in the public interest to enter this Order Making Findings and Revoking Registration of Securities of WebXU Pursuant to Section 12(j) of the Securities Exchange Act of 1934 ("Exchange Act") ("Order") against WebXU, Inc. ("WebXU" or "Respondent").

II.

WebXU has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over it and the subject matter of these proceedings, which are admitted, WebXU consents to entry of this Order, as set forth below.

III.

On the basis of this Order and WebXU's Offer, the Commission finds that:

1. WebXU (CIK No. 0001416729) is a Delaware corporation with its principal executive offices located in Santa Monica, California. At all times relevant to this proceeding, the securities of WebXU have been registered under Exchange Act Section 12(g).

2. WebXU is delinquent in its periodic filings with the Commission, having not filed any periodic reports since it filed a Form 10-K for the period ended December 31, 2012. Since then it has not filed any required Forms 10-K or Forms 10-Q.

3. Exchange Act Section 13(a) and the rules promulgated thereunder require issuers of securities registered pursuant to Exchange Act Section 12 to file with the Commission current and accurate information in periodic reports, even if the registration is voluntary under Section 12(g). Specifically, Rule 13a-1 requires issuers to file annual reports, and Rule 13a-13 requires domestic issuers to file quarterly reports.

4. As a result of failing to file its required periodic reports since December 31, 2012, WebXU has violated Exchange Act Section 13(a) and Rules 13a-1 and 13a-13 thereunder.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanction agreed to in WebXU's Offer.

Accordingly, it is hereby ORDERED that:

Pursuant to Exchange Act Section 12(j), registration of each class of WebXU's securities registered pursuant to Exchange Act Section 12 be, and hereby is, revoked.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73885 / December 19, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-13454

In the Matter of HENNESSEE GROUP LLC and CHARLES J. GRADANTE, Respondents.	ORDER AUTHORIZING THE TRANSFER OF RESIDUAL FUNDS AND ANY FUTURE FUNDS RECEIVED BY THE FAIR FUND TO THE U.S. TREASURY, DISCHARGING THE FUND ADMINISTRATOR, AND TERMINATING THE FAIR FUND

On April 22, 2009, the Securities and Exchange Commission ("Commission") issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (the "Order") against Hennessee Group LLC ("Hennessee") and Charles J. Gradante (collectively, "Respondents") (Advisers Act Rel. No. 2871 (April 22, 2009)). The Order required Respondents to jointly and severally pay $714,644.12 in disgorgement and prejudgment interest, and $100,000 as a civil penalty. The Order also created a Fair Fund pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002. A total of $514,644.12 was paid into the Fair Fund by Respondents.[1]

On March 31, 2011, the Commission issued an Order Approving Plan and Appointing a Fund Administrator, whereby Yuri B. Zelinsky was appointed as the Fund Administrator (Exchange Act Rel. No. 64156 (March 31, 2011)). On July 26, 2012, the Commission issued an Order Directing Disbursement of a Fair Fund that authorized a disbursement of $504,619.82 as provided for in the Distribution Plan (Exchange Act Rel. No. 67514 (July 26, 2012)).

On or about September 18, 2012, the Fair Fund distributed $504,619.82 to twenty-nine Eligible Investors affected by the conduct discussed in the Order. Pursuant to the Distribution Plan, distributions were made to Eligible Investors who (a) were harmed by the conduct described in the Order; and (b) had not received compensation from Hennessee in an amount at

[1] In February 2010, the Commission authorized the staff to credit a $300,000.00 payment made by Hennessee to the Bayou Funds' bankruptcy estate against the $714,644.12 of disgorgement and prejudgment interest ordered to be paid by the Respondents in this matter. As a result, the amount of disgorgement and prejudgment interest paid to the Commission was reduced to $414,644.12.

least equal to the advisory fees paid to Bayou Funds by or on behalf of those customers related to their investments in the Bayou Funds. In addition, the Fair Fund paid a total of $9,869.86 in taxes and Tax Administrator fees and expenses. A balance of $154.47 remains in the Fair Fund.

The Distribution Plan provides that the Fair Fund shall be eligible for termination and the Fund Administrator shall be discharged after all of the following have occurred: (1) the final accounting has been submitted by the Fund Administrator for approval of, and has been approved by, the Commission; (2) all taxes, fees, and expenses have been paid; and (3) any amount remaining in the Fair Fund has been received by the Commission. A final accounting report, which was submitted to the Commission pursuant to Rule 1105(f) of the Commission's Rules on Fair Fund and Disgorgement Plans, has been approved. In addition, all taxes, fees and expenses have been paid and the Commission is in possession of the remaining funds.

Accordingly, IT IS ORDERED that:

1. The $154.47 balance in the Fair Fund shall be transferred to the U.S. Treasury, and any future funds received by the Fair Fund will also be transferred to the U.S. Treasury;
2. The Fund Administrator is discharged; and
3. The Fair Fund is terminated.

By the Commission.

Brent J. Fields
Secretary

Lynn M. Powalski

By: Lynn M. Powalski
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION

[Release No. IC-31388; File No. 812-14403]

Royal Bank of Canada, et al.; Notice of Application and Temporary Order

December 19, 2014

Agency: Securities and Exchange Commission ("Commission").

Action: Temporary order and notice of application for a permanent order under section 9(c) of the Investment Company Act of 1940 ("Act").

Summary of Application: Applicants have received a temporary order ("Temporary Order") exempting them from section 9(a) of the Act, with respect to an injunction entered against Royal Bank of Canada ("RBC") on December 18, 2014 by the United States District Court for the Southern District of New York ("Court"), in connection with a consent order between RBC and the United States Commodity Futures Trading Commission ("CFTC"), until the Commission takes final action on an application for a permanent order (the "Permanent Order," and with the Temporary Order, the "Orders"). Applicants also have applied for a Permanent Order.

Applicants: RBC, RBC Europe Limited ("RBC EL"), RBC Capital Markets Arbitrage, S.A. ("CMA"), RBC Global Asset Management (U.S.) Inc. ("GAM US"), BlueBay Asset Management LLP ("BlueBay LLP"), BlueBay Asset Management USA LLC ("BlueBay USA"), and RBC Global Asset Management (UK) Limited ("GAM UK") (each an "Applicant" and collectively, the "Applicants").

Filing Date: The application was filed on December 19, 2014.

Hearing or Notification of Hearing: An order granting the application will be issued unless the Commission orders a hearing. Interested persons may request a hearing by writing to the Commission's Secretary and serving Applicants with a copy of the request, personally or by mail. Hearing requests should be received by the Commission by 5:30 p.m. on January 12, 2015, and should be accompanied by proof of service on Applicants, in the form of an affidavit, or for lawyers, a certificate of service. Pursuant to rule 0-5 under the Act, hearing requests should state the nature of the writer's interest, any facts bearing upon the desirability of a hearing on the matter, the reason for the request, and the issues contested. Persons who wish to be notified of a hearing may request notification by writing to the Commission's Secretary.

Addresses: Secretary, U.S. Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090; Applicants: RBC: 200 Bay Street, Toronto, Ontario, Canada M5J 2J5, GAM US, 50 South 6th Street, Minneapolis, MN 55402, BlueBay LLP, 77 Grosvenor Street, London W1K 3JR United Kingdom, BBAM USA, 4 Stamford Plaza, 107 Elm Street, Suite 512, Stamford, CT 06902, GAM UK and RBC EL, Riverbank House, 2 Swan Lane, London EC4R 3BF United Kingdom, and CMA, 16 Rue Notre Dame, Luxembourg, 2240, Luxembourg.

For Further Information Contact: Bruce R. MacNeil, Senior Counsel, at (202) 551-6817, or Melissa R. Harke, Branch Chief, at (202) 551-6821 (Division of Investment Management, Chief Counsel's Office).

Supplementary Information: The following is a temporary order and a summary of the application. The complete application may be obtained via the Commission's website by searching for the file number, or an applicant using the Company name box, at http://www.sec.gov/search/search.htm, or by calling (202) 551-8090.

Applicants' Representations:

1. RBC is a Canadian-chartered bank and a Canada-based global financial services firm. RBC is the ultimate parent of the other Applicants. RBC EL is a United

Kingdom-based subsidiary of RBC that is registered in the United Kingdom to engage in capital market activities. CMA is a Luxembourg-based subsidiary of RBC that engages primarily in interdealer market making and proprietary trading. GAM US is a corporation formed under the laws of Minnesota. BlueBay LLP is a limited liability partnership incorporated in England and Wales. BlueBay USA is a limited liability company formed under the laws of Delaware. GAM UK is a corporation formed under the laws of the United Kingdom. GAM US, BlueBay LLP, BlueBay USA and GAM UK are each a wholly-owned subsidiary of RBC and are each an investment adviser registered under the Investment Advisers Act of 1940. GAM US, BlueBay LLP, BlueBay USA and GAM UK each serve as investment adviser or investment sub-adviser to investment companies registered under the Act, or series of such companies (each a "Fund") and are collectively referred to as the "Fund Servicing Applicants."

2. While no existing company of which RBC is an affiliated person within the meaning of section 2(a)(3) of the Act ("Affiliated Person"), other than the Fund Servicing Applicants, currently serves or acts as an investment adviser or depositor of any Fund, employees' securities company or investment company that has elected to be treated as a business development company under the Act, or principal underwriter (as defined in section 2(a)(29) of the Act) for any open-end management investment company registered under the Act ("Open-End Fund"), unit investment trust registered under the Act ("UIT"), or face-amount certificate company registered under the Act ("FACC") (such activities, "Fund Services Activities"),[1] Applicants request that any relief granted also apply to any existing company of which RBC is an Affiliated Person, other than RBC EL and CMA,

[1] RBC, RBC EL, and CMA are parties to the application, but do not and will not engage in Fund Services Activities.

and to any other company of which RBC may become an Affiliated Person in the future (together with the Fund Servicing Applicants, the "Covered Persons") with respect to any activity contemplated by section 9(a) of the Act.

3. On April 22, 2012, the CFTC filed a complaint, and on October 17, 2012, an amended complaint which superseded the original complaint (the "Complaint") in the Court captioned *Commodity Futures Trading Commission v. Royal Bank of Canada* (the "Action"). The Complaint alleged that RBC entered into certain stock futures contract transactions in "block trades," which are privately negotiated transactions pursuant to exchange rules, and that RBC entered into these block trades through its branches and internal trading accounts, and it traded opposite RBC EL and CMA. The Complaint also alleged a violation of Section 4c(a) of the Commodity Exchange Act ("CEA"), whereby RBC entered into the block trades with an express or implied understanding that the positions resulting from the trades would later be offset or delivered opposite each other, which achieved an economic and futures market nullity for the RBC corporate group because the RBC corporate group as a whole was not exposed to risk in the futures market. Furthermore, the Complaint alleged that, in violation of CFTC Regulation 1.38(a), the express or implied understandings for later trades were not reported to the OneChicago, LLC ("OneChicago") futures exchange "without delay," as required by OneChicago's rules.

4. RBC and the CFTC have reached an agreement to settle the Action. As part of the agreement, the CFTC submitted a consent order ("Consent Order") to the Court. RBC has consented to the entry of the Consent Order by the Court, without admitting or denying the findings set forth therein (other than those relating to the jurisdiction of the

Court and the jurisdiction of the CFTC over the Conduct[2]). On December 18, 2014 the Court entered the Consent Order which enjoins RBC from violating section 4c(a) of the CEA and CFTC Regulation 1.38(a) (the "Injunction") and required RBC to pay a civil monetary penalty of $35,000,000.[3]

<u>Applicants' Legal Analysis</u>:

1. Section 9(a)(2) of the Act, in relevant part, prohibits a person who has been enjoined from engaging in or continuing any conduct or practice in connection with the purchase or sale of a security, or in connection with activities as an underwriter, broker or dealer, from acting, among other things, as an investment adviser or depositor of any registered investment company or a principal underwriter for any Open-End Fund, UIT or FACC. Section 9(a)(3) of the Act makes the prohibition in section 9(a)(2) applicable to a company, any affiliated person of which has been disqualified under the provisions of section 9(a)(2). Section 2(a)(3) of the Act defines "affiliated person" to include, among others, any person directly or indirectly controlling, controlled by, or under common control with, the other person. Applicants state that, taken together, sections 9(a)(2) and 9(a)(3) would have the effect of precluding the Fund Servicing Applicants and Covered Persons from engaging in Fund Services Activities upon the entry of the Injunction against RBC because RBC is an Affiliated Person of each Fund Servicing Applicant and Covered Person.

2. Section 9(c) of the Act provides that, upon application, the Commission shall by order grant an exemption from the disqualification provisions of section 9(a) of

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2 The alleged conduct giving rise to the Injunction (defined below) is referred to herein as the "Conduct."

3 See Consent Order, CFTC v. Royal Bank of Canada, 12-cv-2497, Dkt. No. 124 (S.D.N.Y. Dec. 18, 2014).

the Act, either unconditionally or on an appropriate temporary or other conditional basis, to any person if that person establishes that: (a) the prohibitions of section 9(a), as applied to the person, are unduly or disproportionately severe or (b) the conduct of the person has been such as not to make it against the public interest or the protection of investors to grant the exemption. Applicants have filed an application pursuant to section 9(c) seeking a Temporary Order and a Permanent Order exempting the Fund Servicing Applicants and other Covered Persons from the disqualification provisions of section 9(a) of the Act. The Fund Servicing Applicants and other Covered Persons may, if the relief is granted, in the future act in any of the capacities contemplated by section 9(a) of the Act subject to the applicable terms and conditions of the Orders.

3. Applicants believe they meet the standards for exemption specified in section 9(c). Applicants state that the prohibitions of section 9(a) as applied to them would be unduly and disproportionately severe and that the conduct of Applicants has not been such as to make it against the public interest or the protection of investors to grant the exemption from section 9(a).

4. Applicants state the Conduct did not involve any of the Applicants engaging in Fund Services Activities. Applicants also state that the Conduct did not involve any Fund or the assets of any Fund. In addition, Applicants state that the Conduct involved proprietary trading in accounts owned by RBC, RBC EL and CMA and was not conducted on behalf of any Fund or using assets of any Fund.

5. Applicants state that: (a) none of the current directors, officers or employees of the Fund Servicing Applicants (or any other persons serving in such capacity during the time period covered by the Complaint) participated in the Conduct and (b) the personnel at RBC, RBC EL, or CMA who participated in the Conduct or who may

subsequently be identified by RBC, RBC EL, CMA, or any U.S. or non-U.S. regulatory or enforcement agency as having been responsible for the Conduct have had no, and will not have any involvement in providing Fund Services Activities and will not serve as an officer, director, or employee of any Covered Person. Applicants assert that because the personnel of the Fund Servicing Applicants did not participate in the Conduct, the shareholders of Funds were not affected any differently than if those Funds had received services from any other non-affiliated investment adviser or sub-adviser.

6. Applicants submit that section 9(a) should not operate to bar them from serving the Funds and their shareholders in the absence of improper practices relating to their Fund Services Activities. Applicants state that the section 9(a) disqualification could result in substantial costs to the Funds to which the Fund Servicing Applicants provide investment advisory services, and such Funds' operations would be disrupted, as they sought to engage new advisers or sub-advisers. Applicants assert that these effects would be unduly severe given the Fund Servicing Applicants' lack of involvement in the Conduct. Moreover, Applicants state that RBC has taken remedial actions to address the Conduct, as outlined in the application. Thus, Applicants believe that granting the exemption from section 9(a), as requested, would be consistent with the public interest and the protection of investors.

7. Applicants state that the inability of the Fund Servicing Applicants to continue to provide investment advisory services to Funds would result in those Funds and their shareholders facing unduly and disproportionately severe hardships. Applicants state that they will distribute to the boards of directors of the Funds (the "Boards") written materials describing the circumstances that led to the Injunction and any impact on the Funds, and the application. The written materials will include an offer to discuss the

materials at an in-person meeting with each Board for which the Fund Servicing Applicants provide Fund Services Activities, including the directors who are not "interested persons" of such Funds as defined in section 2(a)(19) of the Act, and their independent legal counsel as defined in rule 0-1(a)(6) under the Act. Applicants state they will provide the Boards with the information concerning the Injunction and the application that is necessary for those Funds to fulfill their disclosure and other obligations under the federal securities laws and will provide them a copy of the Consent Order as entered by the Court.

8. Applicants state that if the Fund Servicing Applicants were barred under section 9(a) of the Act from providing investment advisory services to the Funds, and were unable to obtain the requested exemption, the effect on their businesses and employees would be unduly and disproportionately severe because they have committed substantial capital and other resources to establishing an expertise in advising Funds. Applicants further state that prohibiting the Fund Servicing Applicants from engaging in Fund Services Activities would not only adversely affect their businesses, but would also adversely affect their employees who are involved in those activities. Applicants state that many of these employees working for the Fund Servicing Applicants could experience significant difficulties in finding alternative fund-related employment.

9. Applicants state that certain affiliates of the Applicants have previously received an order under section 9(c) of the Act, as the result of conduct that triggered section 9(a), as described in greater detail in the application.

Applicants' Conditions:

Applicants agree that any order granted by the Commission pursuant to the application will be subject to the following conditions:

1. Any temporary exemption granted pursuant to the application shall be without prejudice to, and shall not limit the Commission's rights in any manner with respect to, any Commission investigation of, or administrative proceedings involving or against, Covered Persons, including without limitation, the consideration by the Commission of a permanent exemption from section 9(a) of the Act requested pursuant to the application or the revocation or removal of any temporary exemptions granted under the Act in connection with the application.

2. Each Applicant and Covered Person will adopt and implement policies and procedures reasonably designed to ensure that it will comply with any terms and conditions of the Orders within 60 days of the date of the Permanent Order.

3. RBC will comply with the terms and conditions of the Consent Order.

4. Applicants will provide written notification to the Chief Counsel of the Commission's Division of Investment Management with a copy to the Chief Counsel of the Commission's Division of Enforcement of a material violation of the terms and conditions of the Orders or Consent Order within 30 days of discovery of the material violation.

Temporary Order:

The Commission has considered the matter and finds that Applicants have made the necessary showing to justify granting a temporary exemption.

Accordingly,

IT IS HEREBY ORDERED, pursuant to section 9(c) of the Act, that the Fund Servicing Applicants and any other Covered Persons are granted a temporary exemption from the provisions of section 9(a), solely with respect to the Injunction, subject to the representations and conditions in the application, from December 18, 2014, until the Commission takes final action on their application for a permanent order.

By the Commission.

Kevin M. O'Neill

Kevin M. O'Neill
Deputy Secretary

SECURITIES AND EXCHANGE COMMISSION

17 CFR Chapter II

[Release Nos. 33-9694, 34-73891, 39-2500, IC-31389; IA- 3986; File No. S7-13-14]

List of Rules to be Reviewed Pursuant to the Regulatory Flexibility Act

AGENCY: Securities and Exchange Commission.

ACTION: Publication of list of rules scheduled for review.

SUMMARY: The Securities and Exchange Commission is publishing a list of rules to be reviewed pursuant to Section 610 of the Regulatory Flexibility Act. The list is published to provide the public with notice that these rules are scheduled for review by the agency and to invite public comment on whether the rules should be continued without change, or should be amended or rescinded to minimize any significant economic impact of the rules upon a substantial number of such small entities.

DATES: Comments should be submitted by [insert date 30 days after publication in the Federal Register].

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/other.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number S7-13-14 on the subject line; or
- Use the Federal eRulemaking Portal (http://www.regulations.gov). Follow the instructions for submitting comments.

Paper comments:

• Send paper comments to Brent Fields, Secretary, Securities and Exchange Commission, 100 F Street NE, Washington, DC 20549-1090.

All submissions should refer to File No. S7-13-14. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/other.shtml). Comments also are available for website viewing and printing in the Commission's Public Reference Room, 100 F Street NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Anne Sullivan, Office of the General Counsel, 202-551-5019.

SUPPLEMENTARY INFORMATION: The Regulatory Flexibility Act ("RFA"), codified at 5 U.S.C. 600-611, requires an agency to review its rules that have a significant economic impact upon a substantial number of small entities within ten years of the publication of such rules as final rules. 5 U.S.C. 610(a). The purpose of the review is "to determine whether such rules should be continued without change, or should be amended or rescinded . . . to minimize any significant economic impact of the rules upon a substantial number of such small entities." 5 U.S.C. 610(a). The RFA sets forth specific considerations that must be addressed in the review of each rule:

- the continued need for the rule;
- the nature of complaints or comments received concerning the rule from the public;

- the complexity of the rule;
- the extent to which the rule overlaps, duplicates or conflicts with other federal rules, and, to the extent feasible, with state and local governmental rules; and
- the length of time since the rule has been evaluated or the degree to which technology, economic conditions, or other factors have changed in the area affected by the rule. 5 U.S.C. 610(c).

The Securities and Exchange Commission, as a matter of policy, reviews all final rules that it published for notice and comment to assess not only their continued compliance with the RFA, but also to assess generally their continued utility. When the Commission implemented the Act in 1980, it stated that it "intend[ed] to conduct a broader review [than that required by the RFA], with a view to identifying those rules in need of modification or even rescission." Securities Act Release No. 6302 (Mar. 20, 1981), 46 FR 19251 (Mar. 30, 1981). The list below is therefore broader than that required by the RFA, and may include rules that do not have a significant economic impact on a substantial number of small entities. Where the Commission has previously made a determination of a rule's impact on small businesses, the determination is noted on the list.

The Commission particularly solicits public comment on whether the rules listed below affect small businesses in new or different ways than when they were first adopted.[1] The rules and forms listed below are scheduled for review by staff of the Commission during the next 12 months. The list includes 25 rules adopted by the Commission in 2003.

Title: **Transactions of Investment Companies With Portfolio and**

[1] Several of the rulemakings identified below included non-substantive rule amendments, such as conforming cross references. The Commission requests that commenters focus on the substantive aspects of the rulemakings indicated in the list.

Subadviser Affiliates

Citation: 17 CFR 270.10f-3; 17 CFR 270.12d3-1; 17 CFR 270.17a-6; 17 CFR 270.17a-10; 17 CFR 270.17d-1; 17 CFR 270.17e-1

Authority: 15 U.S.C. 80a-1 et seq., 80a-34(d), 80a-37, 80a-39.

Description: The rule and rule amendments (i) expand the exemptions for investment companies ("funds") to engage in transactions with "portfolio affiliates" - companies that are affiliated with the fund solely as a result of the fund (or an affiliated fund) controlling them or owning more than five percent of their voting securities and (ii) permit funds to engage in transactions with subadvisers of affiliated funds.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. IC-25888 (January 14, 2003). The Commission considered comments to the proposing release and to the Initial Regulatory Flexibility Analysis prepared in Release No. IC-25557 (Apr. 30, 2002) at that time.

* * * * *

Title: **Conditions for Use of Non-GAAP Financial Measures**

Citation: 17 CFR 244.100, 17 CFR 244.101, 17 CFR 244.102, and 17 CFR 229.10.

Authority: 15 U.S.C. 77b(b), 15 U.S.C. 77f, 15 U.S.C. 77g, 15 U.S.C. 77h, 15 U.S.C. 77s(a), 15 U.S.C. 77z-3, 15 U.S.C. 78c, 15 U.S.C. 78d, 15 U.S.C. 78j, 15 U.S.C. 78l, 15 U.S.C. 78m, 15 U.S.C. 78o, 15 U.S.C. 78w, 15 U.S.C. 78mm, 15 U.S.C. 7202(a), and 15 U.S.C. 7261.

Description: The Commission adopted rules and amendments requiring public companies that disclose or release financial information that is calculated or presented on the basis of methodologies other than in accordance with Generally Accepted Accounting Principles (GAAP) to include, in that disclosure or release, a presentation of the most directly comparable GAAP financial measure and a reconciliation of the disclosed non-GAAP financial measure to that measure. The amendments also provide additional guidance to registrants that include non-GAAP financial measures in Commission filings and require registrants to furnish to the Commission earnings releases or similar announcements on Form 8-K.

Prior Commission Determination Under 5 U.S.C. 610

Pursuant to Section 605(b) of the Regulatory Flexibility Act, the Chairman of the Commission certified that the rules and amendments would not have a significant economic impact on a substantial number of small entities in Release No. 33-8145 (November 5, 2002). The Commission solicited comments concerning the impact on small entities and the RFA certification, but received no comments. The final rule was adopted by the Commission in Release No. 33-8176 (January 22, 2003).

* * * * *

Title: **Insider Trades During Pension Fund Blackout Periods**

Citation: 17 CFR 240.13a-11, 17 CFR 240.15d-11, 17 CFR 245.100, 17 CFR 245.101, 17 CFR 245.102, 17 CFR 245.103, and 17 CFR 245.104.

Authority: 15 U.S.C. 78c, 15 U.S.C. 78m, 15 U.S.C. 78w(a), 15 U.S.C. 78mm, 15 U.S.C. 80a-29, 15 U.S.C. 80a-37, 15 U.S.C. 7202(a), and 15 U.S.C. 7244(a).

Description: The Commission adopted rules and amendments to clarify the application and prevent the evasion of Section 306(a) of the Sarbanes-Oxley Act of 2002, which prohibits any director or executive officer of an equity security issuer from acquiring or transferring any equity security of the issuer during a pension plan blackout period that temporarily prevents plan participants or beneficiaries from engaging in equity securities transactions through their plan accounts, if the director or executive officer acquired the equity security in connection with his or her service or employment as a director or executive officer. In addition, the rules specify the content and timing of the notice that issuers must provide to their directors and executive officers, and to the Commission about the imposition of a pension plan blackout period.

Prior Commission Determination Under 5 U.S.C. 610: A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. 34-47225 (January 22, 2003). The Commission considered comments received on the proposing release and the Initial Regulatory Flexibility Analysis prepared in Release No. 34-46778 (November 6, 2002) at that time.

* * * * *

Title: **Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002.**

Citation: 17 CFR 229.401 and 17 CFR 229.406.

Authority: 15 U.S.C. 77e, 15 U.S.C. 77f, 15 U.S.C. 77g, 15 U.S.C. 77j, 15 U.S.C. 77q, 15 U.S.C. 77s, 15 U.S.C. 77z-3, 15 U.S.C. 78l, 15 U.S.C. 78m, 15 U.S.C. 78o, 15 U.S.C. 78w, 15 U.S.C. 78mm, 15 U.S.C. 7202(a), 15 U.S.C. 7264, and 15 U.S.C. 7265.

Description: The Commission adopted amendments to require companies, other than registered investment companies, to disclose information relating to whether an audit committee financial expert serves on the company's audit committee and the adoption and implementation of a code of ethics that applies to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions.

Prior Commission Determination Under 5 U.S.C. 610: A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. 33-8177 (January 23, 2003). The Commission considered comments received on the proposing release and the Initial Regulatory Flexibility Analysis prepared in Release No. 33-8138 (October 22, 2002) at that time.

* * * * *

Title: **Retention of Records Relevant to Audits and Reviews**

Citation: 17 CFR 210 2-06

Authority: 15 U.S.C. 7202(a), 18 U.S.C. 1519, 15 U.S.C. 77g, 15 U.S.C. 77h, 15 U.S.C. 77j, 15 U.S.C. 77s, 15 U.S.C. 77z-3, 15 U.S.C. 78c 15 U.S.C. 78j-1, 15 U.S.C. 78l, 15 U.S.C. 78m, 15 U.S.C. 78n, 15 U.S.C. 78q, 15 U.S.C. 78w, 15 U.S.C. 78mm, 15 U.S.C. 80a-8, 15 U.S.C. 80a-29, 15 U.S.C. 80a-30, 15 U.S.C. 80a-31, and 15 U.S.C. 80a-37.

Description: The rules were adopted pursuant to Section 802 of the Sarbanes-

Oxley Act of 2002 to require accounting firms to retain for seven years certain records relevant to their audits and reviews of issuers' financial statements. Records to be retained include an accounting firm's workpapers and certain other documents that contain conclusions, opinions, analyses, or financial data related to the audit or review.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Act Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. 33-8189 (January 24, 2003). The Commission considered comments to the proposing release and to the Initial Regulatory Flexibility Analysis prepared in Release No. 33-8151 (November 21, 2002) at that time.

* * * * *

Title: **Certification of Management Investment Company Shareholder Reports and Designation of Certified Shareholder Reports as Exchange Act Periodic Reporting Forms; Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002**

Citation: 17 CFR 270.8b-15; 17 CFR 270.30a-1; 17 CFR 270.30a-2; 17 CFR 270.30a-3; 17 CFR 270.30b1-1; 17 CFR 270.30b1-3; 17 CFR 270.30b2-1; 17 CFR 270.30d-1; 17 CFR 274.101; 17 CFR 274.128

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-1 et seq., 80a-8, 80a-24, 80a-26, 80a-29, 80a-34(d), 80a-37, 80a-39, secs. 3(a) and 302, Pub. L. No. 107-204, 116 Stat. 745.

Description: The Commission adopted rule and form amendments to require registered management investment companies to file certified shareholder reports on new Form N-CSR in accordance with Section 302 of the Sarbanes-Oxley Act. The Commission also adopted new rules to require registered investment management companies to maintain disclosure controls and procedures, to disclose whether they had adopted a code of ethics for their principal executive and senior financial officers, and to disclose whether they have at least one "audit committee financial expert" serving on their audit committees, as required by that Act.

Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. IC-25914 (January 27, 2003). The Commission considered comments to the proposing release and to the Initial Regulatory Flexibility Analysis prepared in Release Nos. IC- 25723 (Aug. 30, 2002) and 25775 (Oct. 22, 2002) at that time.

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Title:	**Disclosure in Management's Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations**
Citation:	17 CFR 229.303.
Authority:	15 U.S.C. 77g, 15 U.S.C. 77j, 15 U.S.C. 77s, 15 U.S.C. 77z-2, 15 U.S.C. 77z-3, 15 U.S.C. 78l, 15 U.S.C. 78m, 15 U.S.C. 78n, 15 U.S.C. 78u-5, 15 U.S.C. 78w, 15 U.S.C. 78mm, 15 U.S.C. 7202(a), and 15 U.S.C. 7261(a).
Description:	The Commission adopted the amendments to require disclosure of off-balance sheet arrangements in a separately captioned subsection of the Management's Discussion and Analysis section of a registrant's disclosure documents. The amendments also require registrants, other than smaller reporting companies, to provide tabular disclosure of aggregate contractual obligations as of the latest fiscal year-end balance sheet date.
Prior Commission Determination Under 5 U.S.C. 610:	A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. 33-8182 (January 28, 2003). The Commission solicited comments concerning the impact on small entities and the Initial Regulatory Flexibility Analysis prepared in Release No. 33-8144 (November 4, 2002), but received no comments

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Title:	**Implementation of Standards of Professional Conduct for Attorneys**
Citation:	17 CFR Part 205
Authority:	15 U.S.C. 7202, 7245, 7262.
Description:	The Commission adopted a rule establishing standards of professional conduct for attorneys who appear and practice before

the Commission on behalf of issuers. Section 307 of the Sarbanes-Oxley Act of 2002 requires the Commission to prescribe minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers. The rule requires an attorney to report evidence of a material violation of securities laws or breach of fiduciary duty or similar violation by the issuer up-the-ladder within the company.

Prior Commission Determination Under 5 U.S.C. 610:

A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. 33-8185 (January 29, 2003). The Commission solicited comments concerning the impact on small entities and the Initial Regulatory Flexibility Analysis prepared in Release No. 33-8150 (Nov. 21, 2002), but received no comments.

* * * * *

Title: **Proxy Voting by Investment Advisers**

Citation: 17 CFR 275.204-2; 17 CFR 275.206(4)-6

Authority: 15 U.S.C. 80b-2(a)(11)(F), 80b-2(a)(17), 80b-3, 80b-4, 80b-6(4), 80b-6a, 80b-11

Description: The rule and rule amendments require investment advisers that exercise voting authority over client securities to adopt written policies and procedures that are reasonably designed to ensure the adviser votes proxies in the best interest of clients, disclose to clients information about those policies and procedures and how clients may obtain information on how the adviser has voted their proxies, and retain certain records relating to proxy voting.

Prior Commission Determination Under 5 U.S.C. 601:

A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act regarding rule 206(4)-6 and rule 204-2 under the Investment Advisers Act of 1940 in conjunction with the adoption of Release No. IA-2106 (January 31, 2003). The Commission considered comments to the proposing release and to the Initial Regulatory Flexibility Analysis prepared in Release No. IA-2059 (September 20, 2002) at that time.

* * * * *

Title: **Disclosure of Proxy Voting Policies and Proxy Voting Records by Registered Management Investment Companies**

Citation: 17 CFR 270.30b1-4; 17 CFR 274.11A; 17 CFR 274.11a-1; 17 CFR 274.11b; 17 CFR 274.128; 17 CFR 274.130

Authority: 15 U.S.C. 77f, 77g, 77h, 77j, 77s, 78c(b), 78l, 78m, 78n, 78o(d), 80a-1 et seq., 80a-24, 80a-26, and 80a-29, 80a-34(d), 80a-37, 80a-39.

Description: The rule and rule amendments require registered management investment companies (i) to provide disclosure about how they vote proxies relating to portfolio securities they hold, (ii) to disclose the policies and procedures that they use to determine how to vote proxies relating to portfolio securities, and (iii) to file with the Commission and to make available to shareholders the specific proxy votes that they cast in shareholder meetings of issuers of portfolio securities.

Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. IC-25922 (January 31, 2003). The Commission considered comments to the proposing release and to the Initial Regulatory Flexibility Analysis prepared in Release No. IC- 25739 (Sept. 20, 2002) at that time.

* * * * *

Title: **Custody of Investment Company Assets with a Securities Depository**

Citation: 17 CFR 270.17f-4

Authority: 15 U.S.C. 80a-1 et seq., 80a-34(d), 80a-37, 80a-39.

Description: The rule amendments expand the types of investment companies that may maintain assets with a depository, and update the conditions they must follow to use a depository. The amendments respond to developments in securities depository practices and commercial law since the rule was adopted.

Prior Commission Determination

Under 5 U.S.C. 601:

A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. IC-25934 (February 13, 2003). The Commission considered comments to the proposing release and to the Initial Regulatory Flexibility Analysis prepared in Release No. IC-25266 (Nov. 15, 2001) at that time.

* * * * *

Title:

Definition of Terms in and Specific Exemptions for Banks, Savings Associations, and Savings Banks Under Sections 3(a)(4) and 3(a)(5) of the Securities Exchange Act of 1934

Citation:

17 CFR 240.3a5-1, 17 CFR 240.3b-18, 17 CFR 240.15a-8, and 17 CFR 240.15a-11

Authority:

15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, and 80b-11.

Description:

The Commission adopted amendments to its rule granting an exemption to banks from dealer registration for a de minimis number of riskless principal transactions, and to its rule that defines terms used in the bank exception to dealer registration for asset-backed transactions. The Commission also adopted a new exemption for banks from the definition of broker and dealer under the Securities Exchange Act of 1934 for certain securities lending transactions. In addition, the Commission extended the exemption from rescission liability under Exchange Act Section 29 to contracts entered into by banks acting in a dealer capacity before March 31, 2005. These rules addressed certain of the exceptions for banks from the definitions of "broker" and "dealer" that were added to the Securities Exchange Act by the Gramm-Leach-Bliley Act.

Prior Commission Determination Under 5 U.S.C. 610:

Pursuant to Section 605(b) of the Regulatory Flexibility Act, the Commission certified that the amendment to the rule would not have a significant economic impact on a substantial number of small entities. This certification was incorporated into the proposing release, Release No. 34-46745 (November 5, 2002).

As stated in the adopting release, No. 34-47364 (February 14, 2003), the Commission received no comments concerning the impact on small entities or the Regulatory Flexibility Act Certification.

* * * * *

Title: **Regulation Analyst Certification**

Citation: 17 CFR 242.500 through 505.

Authority: 15 U.S.C. 77g, 77q(a), 77s(a), 78b, 78c, 78g(c)(2), 78i(a), 78j, 78k-1(c), 78l, 78m, 78mm, 78n, 78o(b), 78o(c), 78o(g), 78q(a), 78q(b), 78q(h), 78w(a), 78dd-1, 80a-23, 80a-29, and 80a-37.

Description: Regulation Analyst Certification ("Regulation AC") requires that brokers, dealers, and certain persons associated with a broker or dealer include in research reports certifications by the research analyst that the views expressed in the report accurately reflect his or her personal views, and disclose whether or not the analyst received compensation or other payments in connection with his or her specific recommendations or views. Broker-dealers are also required to obtain periodic certifications by research analysts in connection with the analyst's public appearances.

Prior Commission Determination Under 5 U.S.C. 610: Pursuant to Section 605(b) of the Regulatory Flexibility Act, the Commission certified that Regulation AC would not have a significant economic impact on a substantial number of small entities. This certification, including the reasons supporting the certification, was set forth in the proposing release, Release No. 33-8119 (August 2, 2002). The Commission solicited comments on the potential impact of Regulation AC on small entities in the proposing release. No comments were received that discussed the Regulatory Flexibility Act Certification. However, in the adopting release, Release No. 33-8193 (February 20, 2003), in response to other comments, the Commission revised its estimates and concluded that the total burden in hours required to comply with proposed Regulation AC would be approximately 5.78 hours per year, per small firm, as compared to the original estimate of two hours and two minutes per year, per small firm.

* * * * *

Title: **Standards Relating to Listed Company Audit Committees**

Citation: 17 CFR 229.401 and 17 CFR 240.10A-3.

Authority: 15 U.S.C. 77b, 15 U.S.C. 77f, 15 U.S.C. 77g, 15 U.S.C. 77h, 15 U.S.C. 77j, 15 U.S.C. 77q, 15 U.S.C. 77s, 15 U.S.C. 78c(b), 15 U.S.C. 78j-1, 15 U.S.C. 78l, 15 U.S.C. 78m, 15 U.S.C. 78n, 15 U.S.C. 78o, 15 U.S.C. 78w, 15 U.S.C. 78mm, 15 U.S.C. 80a-8, 15 U.S.C. 80a-20, 15 U.S.C. 80a-24(a), 15 U.S.C. 80a-29, 15 U.S.C. 80a-37, and 15 U.S.C. 7202.

Description: The Commission adopted rules to direct the national securities exchanges and national securities associations to prohibit the listing of any security of an issuer that is not in compliance with the audit committee requirements mandated by the Sarbanes-Oxley Act of 2002. In addition, the Commission adopted amendments changing its disclosure requirements regarding audit committees.

Prior Commission Determination Under 5 U.S.C. 610: A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. 33-8220 (April 9, 2003). The Commission solicited comments concerning the impact on small entities and the Initial Regulatory Flexibility Analysis prepared in Release No. 33-8173 (January 8, 2003), but received no comments.

* * * * *

Title: **Customer Identification Programs for Mutual Funds**

Citation: 17 CFR 270.0-11

Authority: 15 U.S.C. 80a-1 et seq., 80a-34(d), 80a-37, 80a-39.

Description: The rule implements section 326 of the USA PATRIOT Act of 2001 and requires investment companies (i) to implement procedures to verify the identity of any person seeking to open an account, (ii) to the extent reasonable and practicable, to maintain records of the information used to verify the person's identity, and (iii) to determine whether the person appears on any lists of known or suspected terrorists or terrorist organizations provided to investment companies by any government agency.

Prior Commission Determination Under

5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. IC-26031 (April 29, 2003). The Commission considered comments to the proposing release and to the Initial Regulatory Flexibility Analysis prepared in Release No. 34- 46192 (July 12, 2002) at that time.

* * * * *

Title: **Improper Influence on Conduct of Audits**

Citation: 17 CFR 240 13b2-2.

Authority: 15 U.S.C. 7202(a), 15 U.S.C. 7242, 15 U.S.C. 77e, 15 U.S.C. 77f, 15 U.S.C. 77g, 15 U.S.C. 77h, 15 U.S.C. 77j, 15 U.S.C. 77s, 15 U.S.C. 78c, 15 U.S.C. 78j-1, 15 U.S.C 78l, 15 U.S.C. 78m, 15 U.S.C. 78n, 15 U.S.C. 78o, 15 U.S.C. 78q, 15 U.S.C. 78w, 15 U.S.C. 80a-6, 15 U.S.C. 80a-8, 15 U.S.C 80a-20, 15 U.S.C. 80a-29, 15 U.S.C 80a-30, and 15 U.S.C. 80a-37.

Description: The rules were adopted pursuant to the requirements of Section 303 of the Sarbanes-Oxley Act of 2002 to prohibit officers and directors of an issuer, and persons acting under the direction of an officer or director, from taking any action to coerce, manipulate, mislead, or fraudulently influence the auditor of the issuer's financial statements if that person knew or should have known that such action, if successful, could result in rendering the financial statements materially misleading.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Act Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. 34-47890 (May 20, 2003). The Commission considered comments to the proposing release and to the Initial Regulatory Flexibility Analysis prepared in Release No. 34-46685 (October 18, 2002) at that time.

* * * * *

Title:	**Management's Reports on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports**
Citation:	17 CFR 210.1-02, 17 CFR 210.2-02, 17 CFR 229.307, 17 CFR 229.308, 17 CFR 240.12b-15, 17 CFR 240.13a-14, 17 CFR 240.13a-15, 17 CFR 240.15d-14, 17 CFR 240.15d-15.
Authority:	15 U.S.C. 77e, 15 U.S.C. 77f, 15 U.S.C. 77g, 15 U.S.C. 77j, 15 U.S.C. 77q, 15 U.S.C. 77s, 15 U.S.C. 78l, 15 U.S.C. 78m, 15 U.S.C. 78o, 15 U.S.C. 78w, 15 U.S.C. 78mm, 15 U.S.C. 80a-8, 15 U.S.C. 80a-29, 15 U.S.C. 80a-30, 15 U.S.C. 80a-37, 15 U.S.C. 7202(a), 15 U.S.C. 7241, 15 U.S.C. 7262, 15 U.S.C. 7263, and 18 U.S.C. 1350.
Description:	The rules and amendments were adopted in light of Congress' directive in Section 404 of the Sarbanes-Oxley Act of 2002 to require reporting companies, other than registered investment companies, to include in their annual reports a report of management on the company's internal control over financial reporting. The internal control report must include management's assessment of the effectiveness of the company's internal control over financial reporting as of the end of its most recent fiscal year, as well as a statement that the registered public accounting firm that audited the company's financial statements included in the annual report has issued an attestation report on management's assessment. The rules also require companies to file the registered public accounting firm's attestation report as part of its annual report. Further, the rules require that management evaluate any change in the company's internal control over financial reporting that occurred during a fiscal quarter that has or is reasonably likely to materially affect the company's internal control over financial reporting. In addition, the amendments require companies to provide the certifications required by Sections 302 and 906 of the Sarbanes-Oxley Act as exhibits to certain periodic reports. In 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act amended Section 404 of the Sarbanes-Oxley Act to provide that Section 404(b) shall not apply with respect to any audit report prepared for an issuer that is neither an accelerated filer, nor a large accelerated filer, as defined in Exchange Act Rule 12b-2. In 2010, the Commission adopted conforming amendments to its rules.
Prior Commission Determination Under	A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility

5 U.S.C. 610: Act in conjunction with the adoption of Release No. 33-8238 (June 5, 2003). The Commission solicited comments with respect to the rules and amendments in two separate proposing releases, Release Nos. 33-8138 (October 22, 2002) and 33-8212 (March 21, 2003). The Commission also solicited comments concerning the impact on small entities and the Initial Regulatory Flexibility Analysis, but received no comments on the impact on small entities of the new certification requirements.

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Title: **Certain Research and Development Companies**

Citation: 17 CFR 270.3a-8

Authority: 15 U.S.C. 80a-1 et seq., 80a-34(d), 80a-37, 80a-39.

Description: The rule provides a nonexclusive safe harbor from the definition of an investment company for certain bona fide research and development companies.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. IC-26077 (June 16, 2003). The Commission solicited comments concerning the impact on small entities and the Initial Regulatory Flexibility Analysis prepared in Release No. IC- 25835 (Nov. 26, 2002) but received no comments.

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Title: **Custody of Funds or Securities of Clients by Investment Advisers**

Citation: 17 CFR 275.206(4)-2; 17 CFR 279.1

Authority: 15 U.S.C. 80b-1 *et seq*., 80b-2(a)(11)(F), 80b-2(a)(17), 80b-3, 80b-4, 80b-6(4), 80b-6a, 80b-11

Description: The amendments to the custody rule conformed the rule to modern custodial practices and required advisers that have custody of client funds or securities to maintain those assets with broker-dealers, banks, or other qualified custodians. The amendments were designed to enhance protections for client assets while reducing burdens on advisers that have custody of client assets.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act with respect to amended rule 206(4)-2 under the Advisers Act and to amended Part 1A, Item 9 and Part II, Item 14 of Form ADV in conjunction with the adoption of Release No. IA- 2176 (September 25, 2003). The Commission solicited comments concerning the impact on small entities and the Initial Regulatory Flexibility Analysis prepared in Release No. IA-2044 (July 18, 2002), but received no comments.

* * * * *

Title: **Amendments to Investment Company Advertising Rules**

Citation: 17 CFR 270.34b-1

Authority: 15 U.S.C. 80a-1 et seq., 80a-34(d), 80a-37, 80a-39.

Description: The rule amendments (i) require enhanced disclosure in investment company advertisements to encourage advertisements that convey balanced information to prospective investors, particularly with respect to past performance, and (ii) implement section 24(g) of the Investment Company Act by permitting the use of a prospectus under section 10(b) of the Securities Act with respect to securities issued by an investment company that includes information the substance of which is not included in the investment company's statutory prospectus.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. IC-26195 (September 29, 2003). The Commission considered comments to the proposing release and to the Initial Regulatory Flexibility Analysis prepared in Release No. IC- 25575 (May 17, 2002) at that time.

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Title:	**Purchases of Certain Equity Securities by the Issuer and Others**
Citation:	17 CFR 228.703; 17 CFR 229.703; 17 CFR 240.10b-18; 17 CFR 249.220f; 17 CFR 249.308a; 17 CFR 249.308b; 17 CFR 249.310; 17 CFR 249.310b; 17 CFR 249.33117 CFR 270.23c-1; 17 CFR 274.128; 17 CFR 274.201
Authority:	15 U.S.C. 77f, 77g, 77h, 77j, 77K, 77s, 77z-2, 77z-3, 77aa(25), 77aa(26), 77ddd, 77eee, 77ggg, 77hhh, 77iii, 77jjj, 77nnn, 77sss, 77ttt, 78c,78c(b),), 78d, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78l, 78m, 78n, 78o(d), 78u-5, 78w, 78x, 78ll, 78mm, 79e, 79j, 79n, 79q, 79t, 80a-1 et seq., 80a-8, 80a-9, 80a-20, 80a-23, 80a-24, 80a-26, 80a-29, 80a-30, 80a-24, 80a-26, 80a-29, 80a-34(d), 80a-38(a), 80a-37, 80a-39, 80b-3, 80b-4, 80b-11, 7201 et seq., 18 U.S.C. 1350.
Description:	The rule amendments provide issuers with a "safe harbor" from liability for manipulation when they repurchase their common stock in the market in accordance with the rule's manner, timing, price, and volume conditions. The amendments are intended to simplify and update the safe harbor provisions in light of market developments since the rule's adoption. To enhance the transparency of issuer repurchases, the Commission also adopted amendments to a number of regulations and forms regarding disclosure of repurchases of equity securities by the issuer and affiliated purchasers (both open market and private transactions), regardless of whether the repurchases are effected in accordance with the issuer repurchase safe harbor rule.
Prior Commission Determination Under 5 U.S.C. 601:	A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. 33-8335 (November 10, 2003). The Commission solicited comments concerning the impact on small entities and the Initial Regulatory Flexibility Analysis prepared in Release No. 34-46980 (December 10, 2002), but received no comments.

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Title: **Disclosure Regarding Nominating Committee Functions and Communications Between Security Holders and Boards of Directors**

Citation: 17 CFR 270.30a-2; 17 CFR 274.128

Authority: 15 U.S.C. 80a-1 et seq., 80a-34(d), 80a-37, 80a-39.

Description: The rule amendments impose new disclosure requirements and amendments to existing disclosure requirements to enhance the transparency of the operations of boards of directors. Specifically, the Commission adopted enhancements to existing disclosure requirements regarding the operations of board nominating committees and a new disclosure requirement concerning the means, if any, by which security holders may communicate with directors. These rules require disclosure but do not mandate any particular action by a company or its board of directors; rather, the new disclosure requirements are intended to make more transparent to security holders the operation of the boards of directors of the companies in which they invest.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. IC-26262 (November 24, 2003). The Commission solicited comments on the proposing release and on the Initial Regulatory Flexibility Analysis prepared in Release No. 34-48301 (August 8, 2003). The Commission received no comments on the Initial Regulatory Flexibility Analysis, but it did receive comments on the impact of the proposed rules on small business issuers. The Commission considered those comments in the adopting release.

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Title: **Processing Requirements for Cancelled Security Certificates**

Citation: 17 CFR 240.17f-1, 17 CFR 240.17Ad-7, 17 CFR 240.17Ad-12, and 17 CFR 240.17Ad-19

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78l, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78ll, 78mm, 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7202, 7241, 7262, and 7263, and 18 U.S.C. 1350.

Description: This rule requires every transfer agent to establish and implement written procedures for the cancellation, storage, transportation, destruction, or other disposition of securities certificates. The rule requires transfer agents to mark each cancelled securities certificate with the word "cancelled"; maintain a secure storage area for cancelled certificates; maintain a retrievable database of all cancelled, destroyed, or otherwise disposed of certificates; and have specific procedures for the destruction of cancelled certificates. Additionally, the Commission amended its lost and stolen securities rule and its transfer agent safekeeping rule to make it clear that these rules apply to unissued and cancelled certificates.

Prior Commission Determination Under 5 U.S.C. 610: A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with the adoption of Release No. 34-48931 (December 16, 2003). The Commission solicited comment on the Initial Regulatory Flexibility Analysis prepared in the proposing release, Release No. 34-43401 (October 2, 2000), but received no comment on that analysis. The Commission did receive comments related to small business, and considered those comments in the adopting release.

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Title: **Compliance Programs of Investment Companies and Investment Advisers**

Citation: 17 CFR 270.38a-1; 17 CFR 275.204-2; 17 CFR 275.206(4)-7

Authority: 15 U.S.C. 80a-1 *et seq.*, 80a-34(d), 80a-37, 80a-39, 80b-1 *et seq.*, 80b-2(a)(11)(F), 80b-2(a)(17), 80b-3, 80b-4, 80b-6(4), 80b-6a, 80b-11

Description: The rules require each investment company and investment adviser registered with the Commission and each business development company to (i) adopt and implement written compliance policies and procedures, (ii) review those policies and procedures annually, and (iii) appoint a compliance officer to be responsible for administering the policies and procedures. The rules also impose a new recordkeeping requirement.

Prior Commission Determination Under 5 U.S.C. 601: A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act regarding rule 38a-1 under the Investment Company Act of 1940, new rule 206(4)-7 under the Investment Advisers Act, and amendments to rule 204-2 under the Investment Advisers Act, and to Part 1, Schedule A, Item 2(a) of Form ADV in conjunction with the Commission's adoption of Release No. IA-2204 (December 17, 2003). The Commission considered comments on the proposing release and on the Initial Regulatory Flexibility Analysis prepared in Release No. IC-25925 (Feb. 5, 2003) at that time.

* * * * *

Title: **Recordkeeping Requirements for Registered Transfer Agents**

Citation: 17 CFR 240. 240.17Ad-7

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z-2, 77z-3, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78e, 78f, 78g, 78i, 78j, 78j-1, 78k, 78k-1, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78u-5, 78w, 78x, 78*ll*, 78mm, 79q, 79t, 80a-20, 80a-23, 80a-29, 80a-37, 80b-3, 80b-4, 80b-11, 7202, 7241, 7262, and 7263, and 18 U.S.C. 1350.

Description: The Commission amended its rule concerning recordkeeping requirements for registered transfer agents. The amendments made it clear that registered transfer agents may use electronic, microfilm, and microfiche media as a substitute for hard copy records, including cancelled stock certificates, for purposes of complying with the Commission's transfer agent recordkeeping rules and that a third party on behalf of a registered transfer agent may place into escrow the required software information.

Prior Commission Determination Under 5 U.S.C. 610: A Final Regulatory Flexibility Analysis was prepared in accordance with Section 604 of the Regulatory Flexibility Act in conjunction with Release No. 34-48949 (December 18, 2003). The Commission received comment letters in response to the Initial Regulatory Flexibility Analysis in the proposing release, Release

No. 34-48036 (June 16, 2003), that did not address the issues presented in the proposing release.

By the Commission.

Brent J. Fields
Secretary

Dated: December 19, 2014

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73896 / December 19, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-13446

In the Matter of AMERICAN SKANDIA INVESTMENT SERVICES, INC., Respondent.	ORDER AUTHORIZING THE TRANSFER OF RESIDUAL FUNDS AND ANY FUTURE FUNDS RECEIVED BY THE FAIR FUND TO THE U.S. TREASURY, DISCHARGING THE FUND ADMINISTRATOR, AND TERMINATING THE FAIR FUND

On April 17, 2009, the Securities and Exchange Commission ("Commission" or "SEC") issued an Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order (the "Order") against American Skandia Investment Services, Inc. ("American Skandia" or "Respondent") (Advisers Act Rel. No. 2867 (April 17, 2009)). The Order required American Skandia to pay $34,000,000 in disgorgement and $34,000,000 as a civil penalty. The Order also created a Fair Fund pursuant to Section 308(a) of the Sarbanes-Oxley Act of 2002. A total of $68,000,000 was paid into the Fair Fund by the Respondent. The Respondent was required to pay all reasonable costs of the distribution.

On August 16, 2010, the Commission issued an Order Approving Plan of Distribution, Appointing Fund Administrator, and Waiving Bond whereby Rust Consulting, Inc. was appointed as the Fund Administrator (Exchange Act Rel. No. 62733 (August 16, 2010)). The Commission subsequently issued four orders directing disbursement. On January 25, 2011, the Commission issued the first Order Directing Disbursement of Fair Fund in the amount of $60,945,010.08 (Exchange Act Rel. No. 63765 (January 25, 2011)). On June 13, 2011, the Commission issued the second Order Directing Disbursement of Fair Fund in the amount of $7,148,968.27 (Exchange Act Rel. No. 64651 (June 13, 2011)). On February 17, 2012, the Commission issued the third Order Directing Disbursement of Fair Fund in the amount of $5,075,505,42 (Exchange Act Rel. No. 66425 (February 17, 2012)). On June 6, 2012, the Commission issued the fourth Order Directing Disbursement of Fair Fund in the amount of $208,304.40 (Exchange Act Rel. No. 67149 (June 6, 2012)).

Pursuant to the Distribution Plan, the Fair Fund was distributed first to the underlying investors of six insurance-dedicated funds ("IDFs") that received at least $1 million in allocations from the Fair Fund and to the asset base of sixteen IDFs that received less than $1 million. Fair Fund monies that remained undistributed because distributions to the underlying investors were not negotiated were distributed to the asset base of the six IDFs, or successor IDFs, that received at least $1 million in allocations from the Fair Fund.

The Fair Fund earned a total of $247,386.86 in interest. In addition, $760.57 was deducted from the Fair Fund to reimburse the Tax Administrator for bond fees, $13,850.20 was paid for investment/banking fees, and a total of $82,240.00 was paid for federal and state taxes. A balance of $39,839.09 remains in the Fair Fund.

The Distribution Plan provides that the Fair Fund shall be eligible for termination and the Fund Administrator shall be discharged after all of the following have occurred: (1) a final accounting, in an SEC standard accounting format provided by the staff, has been submitted by the Fund Administrator for approval of, and has been approved by, the Commission; (2) all taxes, fees, and expenses have been paid; and (3) any amount remaining in the Escrow Account of the Fair Fund has been received by the Commission. A final accounting report, which was submitted to the Commission pursuant to Rule 1105(f) of the Commission's Rules on Fair Fund and Disgorgement Plans, has been approved. In addition, all taxes, fees and expenses have been paid and the Commission is in possession of the remaining funds.

Accordingly, IT IS ORDERED that:

1. The $39,839.09 balance in the Fair Fund shall be transferred to the U.S. Treasury, and any future funds received by the Fair Fund will also be transferred to the U.S. Treasury;
2. The Fund Administrator is discharged; and
3. The Fair Fund is terminated.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson
By: Jill M. Peterson
Assistant Secretary

AUTHENTICATED U.S. GOVERNMENT INFORMATION GPO

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Monday, December 22, 2014

Part XXV

Securities and Exchange Commission

Semiannual Regulatory Agenda

47 of 55

SECURITIES AND EXCHANGE COMMISSION

17 CFR Ch. II

[Release Nos. 33–9663, 34–73341, IA–3945, IC–31283, File No. S7–10–14]

Regulatory Flexibility Agenda

AGENCY: Securities and Exchange Commission.

ACTION: Semiannual regulatory agenda.

SUMMARY: The Securities and Exchange Commission is publishing the Chair's agenda of rulemaking actions pursuant to the Regulatory Flexibility Act (RFA) (Pub. L. 96–354, 94 Stat. 1164) (Sep. 19, 1980). The items listed in the Regulatory Flexibility Agenda for Fall 2014 reflect only the priorities of the Chair of the U.S. Securities and Exchange Commission, and do not necessarily reflect the view and priorities of any individual Commissioner.

Information in the agenda was accurate on October 10, 2014, the date on which the Commission's staff completed compilation of the data. To the extent possible, rulemaking actions by the Commission since that date have been reflected in the agenda. The Commission invites questions and public comment on the agenda and on the individual agenda entries.

The Commission is now printing in the **Federal Register**, along with our preamble, only those agenda entries for which we have indicated that preparation of an RFA analysis is required.

The Commission's complete RFA agenda will be available online at *www.reginfo.gov.*

DATES: Comments should be received on or before January 21, 2015.

ADDRESSES: Comments may be submitted by any of the following methods:

Electronic Comments

- Use the Commission's Internet comment form (*http://www.sec.gov/rules/other.shtml*); or
- Send an email to *rule-comments@sec.gov*. Please include File Number S7–10–14 on the subject line; or
- Use the Federal eRulemaking Portal (*http://www.regulations.gov*). Follow the instructions for submitting comments.

Paper Comments

- Send paper comments in triplicate to Brent J. Fields, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549–1090.

All submissions should refer to File No. S7–10–14. This file number should be included on the subject line if email is used. To help us process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/other.shtml*). Comments are also available for Web site viewing and printing in the Commission's Public Reference Room, 100 F Street NE., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

FOR FURTHER INFORMATION CONTACT: Anne Sullivan, Office of the General Counsel, 202–551–5019.

SUPPLEMENTARY INFORMATION: The RFA requires each Federal agency, twice each year, to publish in the **Federal Register** an agenda identifying rules that the agency expects to consider in the next 12 months that are likely to have a significant economic impact on a substantial number of small entities (5 U.S.C. 602(a)). The RFA specifically provides that publication of the agenda does not preclude an agency from considering or acting on any matter not included in the agenda and that an agency is not required to consider or act on any matter that is included in the agenda (5 U.S.C. 602(d)). The Commission may consider or act on any matter earlier or later than the estimated date provided on the agenda. While the agenda reflects the current intent to complete a number of rulemakings in the next year, the precise dates for each rulemaking at this point are uncertain. Actions that do not have an estimated date are placed in the long-term category; the Commission may nevertheless act on items in that category within the next 12 months. The agenda includes new entries, entries carried over from prior publications, and rulemaking actions that have been completed (or withdrawn) since publication of the last agenda.

The following abbreviations for the acts administered by the Commission are used in the agenda:

"Securities Act"—Securities Act of 1933

"Exchange Act"—Securities Exchange Act of 1934

"Investment Company Act"—Investment Company Act of 1940

"Investment Advisers Act"—Investment Advisers Act of 1940

"Dodd Frank Act"—Dodd-Frank Wall Street Reform and Consumer Protection Act

The Commission invites public comment on the agenda and on the individual agenda entries.

By the Commission.

Dated: October 10, 2014.

Kevin M. O'Neill,

Deputy Secretary.

DIVISION OF CORPORATION FINANCE—PROPOSED RULE STAGE

Sequence No.	Title	Regulation Identifier No.
557	Implementation of Titles V and VI of the JOBS Act	3235–AL40

DIVISION OF CORPORATION FINANCE—FINAL RULE STAGE

Sequence No.	Title	Regulation Identifier No.
558	Rules Governing the Offer and Sale of Securities Through Crowdfunding Under Section 4(a)(6) of the Securities Act.	3235–AL37
559	Amendments to Regulation D, Form D and Rule 156 Under the Securities Act	3235–AL46
560	Treatment of Certain Communications Involving Security-Based Swaps That May be Purchased Only by Eligible Contract Participants.	3235–AL41

DIVISION OF INVESTMENT MANAGEMENT—FINAL RULE STAGE

Sequence No.	Title	Regulation Identifier No.
561	Temporary Rule Regarding Principal Trades With Certain Advisory Clients	3235–AL56

DIVISION OF TRADING AND MARKETS—LONG-TERM ACTIONS

Sequence No.	Title	Regulation Identifier No.
562	Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934	3235–AL14

DIVISION OF TRADING AND MARKETS—COMPLETED ACTIONS

Sequence No.	Title	Regulation Identifier No.
563	Rules for Nationally Recognized Statistical Rating Organizations	3235–AL15

SECURITIES AND EXCHANGE COMMISSION (SEC)

Division of Corporation Finance

Proposed Rule Stage

557. Implementation of Titles V and VI of the Jobs Act

Legal Authority: Pub. L. 112–106

Abstract: The Division is considering recommending that the Commission propose rules or amendments to rules to implement titles V (Private Company Flexibility and Growth) and VI (Capital Expansion) of the JOBS Act.

Timetable:

Action	Date	FR Cite
NPRM	10/00/15	

Regulatory Flexibility Analysis Required: Yes.

Agency Contact: Steven G. Hearne, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–3430.

RIN: 3235–AL40

SECURITIES AND EXCHANGE COMMISSION (SEC)

Division of Corporation Finance

Final Rule Stage

558. Rules Governing the Offer and Sale of Securities Through Crowdfunding Under Section 4(A)(6) of the Securities Act

Legal Authority: 15 U.S.C. 77a *et seq.*; 15 U.S.C. 78a *et seq.*; Pub. L. 112–108, secs 301 to 305

Abstract: The Commission proposed rules to implement title III of the JOBS Act by prescribing rules governing the offer and sale of securities through crowdfunding under new section 4(a)(6) of the Securities Act.

Timetable:

Action	Date	FR Cite
NPRM	11/05/13	78 FR 66428
NPRM Comment Period End.	02/03/14	
Final Action	10/00/15	

Regulatory Flexibility Analysis Required: Yes.

Agency Contact: Sebastian Gomez Abero, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–3500.

Leila Bham, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–5532.

RIN: 3235–AL37

559. Amendments to Regulation D, Form D and Rule 156 Under the Securities Act

Legal Authority: 15 U.S.C. 77a *et seq.*

Abstract: The Commission proposed rule and form amendments to enhance the Commission's ability to evaluate the development of market practices in offerings under Rule 506 of Regulation D and address concerns that may arise in connection with permitting issuers to engage in general solicitation and general advertising under new paragraph (c) of Rule 506.

Timetable:

Action	Date	FR Cite
NPRM	07/24/13	78 FR 44806
NPRM Comment Period End.	09/23/13	
NPRM Comment Period Re-opened.	10/03/13	78 FR 61222
NPRM Comment Period End.	11/04/13	
Final Action	10/00/15	

Regulatory Flexibility Analysis Required: Yes.

Agency Contact: Charles Kwon, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–3500.

Ted Yu, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–3500.

RIN: 3235–AL46

560. Treatment of Certain Communications Involving Security-Based Swaps That May Be Purchased Only by Eligible Contract Participants

Legal Authority: 15 U.S.C. 77e; 15 U.S.C. 77s; 15 U.S.C. 77z–3

Abstract: The Commission proposed a rule under the Securities Act to address the treatment of certain communications involving security-based swaps that may be purchased only by eligible contract participants.

Timetable:

Action	Date	FR Cite
NPRM	09/11/14	79 FR 54224
NPRM Comment Period End.	11/10/14	
Final Action	10/00/15	

Regulatory Flexibility Analysis Required: Yes.

Agency Contact: Andrew Schoeffler, Division of Corporation Finance, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–3860.

RIN: 3235–AL41

SECURITIES AND EXCHANGE COMMISSION (SEC)

Division of Investment Management

Final Rule Stage

561. Temporary Rule Regarding Principal Trades With Certain Advisory Clients

Legal Authority: 15 U.S.C. 80b–6a; 15 U.S.C. 80b–11(a)

Abstract: Rule 206(3)–3T, a rule that provides investment advisers who are also registered broker-dealers an alternative means of compliance with the principal trading restrictions in section 206(3) of the Investment Advisers Act, will expire on December 31, 2014. The Commission proposed a temporary rule to extend that date to December 31, 2016.

Timetable:

Action	Date	FR Cite
NPRM	08/18/14	79 FR 48709
NPRM Comment Period End.	09/17/14	
Next Action	12/00/14	

Regulatory Flexibility Analysis Required: Yes.

Agency Contact: Sarah Buescher, Division of Investment Management, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–5192, *Email: bueschers@sec.gov.*

RIN: 3235–AL56

SECURITIES AND EXCHANGE COMMISSION (SEC)

Division of Trading and Markets

Long-Term Actions

562. Removal of Certain References to Credit Ratings Under the Securities Exchange Act of 1934

Legal Authority: Pub. L. 111–203, sec 939A

Abstract: Section 939A of the Dodd Frank Act requires the Commission to remove certain references to credit ratings from its regulations and to substitute such standards of creditworthiness as the Commission determines to be appropriate. The Commission amended certain rules and one form under the Exchange Act applicable to broker-dealer financial responsibility, and confirmation of transactions. The Commission has not yet finalized amendments to certain rules regarding the distribution of securities.

Timetable:

Action	Date	FR Cite
NPRM	05/06/11	76 FR 26550
NPRM Comment Period End.	07/05/11	
Final Action	01/08/14	79 FR 1522
Final Action Effective.	07/07/14	
Next Action Undetermined.	To Be Determined	

Regulatory Flexibility Analysis Required: Yes.

Agency Contact: John Guidroz, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–6439, *Email: guidrozj@sec.gov.*

RIN: 3235–AL14

SECURITIES AND EXCHANGE COMMISSION (SEC)

Division of Trading and Markets

Completed Actions

563. Rules for Nationally Recognized Statistical Rating Organizations

Legal Authority: 15 U.S.C. 78o–7; 15 U.S.C. 78q; 15 U.S.C. 78mm; Pub. L. 111–203, secs 936, 938, and 943

Abstract: The Commission adopted rules and rule amendments to implement certain provisions of the Dodd Frank Act concerning nationally recognized statistical rating organizations, providers of third-party due diligence services for asset-backed securities, and issuers and underwriters of asset-backed securities.

Timetable:

Action	Date	FR Cite
NPRM	06/08/11	76 FR 33420
NPRM Comment Period End.	08/08/11	
Final Action	09/15/14	79 FR 55078
Final Action Effective.	11/14/14	

Regulatory Flexibility Analysis Required: Yes.

Agency Contact: Raymond Lombardo, Division of Trading and Markets, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549, *Phone:* 202 551–5755, *Email: lombardor@sec.gov.*

RIN: 3235–AL15

[FR Doc. 2014–28993 Filed 12–19–14; 8:45 am]

BILLING CODE 8011–01–P

Chair White
Commissioner Piwowar
Not participating
Commissioner Gallagher
dissent as to primary
violation under the
I.A. Act

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

Investment Advisers Act of 1940
Release No. 3988 / December 22, 2014

Investment Company Act of 1940
Release No. 31393 / December 22, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16325

In the Matter of **F-SQUARED INVESTMENTS, INC.,** **Respondent.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act"), and Sections 9(b) and 9(f) of the Investment Company Act of 1940 ("Investment Company Act") against F-Squared Investments, Inc. ("Respondent" or "F-Squared").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Respondent admits the facts set forth in Appendix A attached hereto, and acknowledges that its conduct as set forth in Appendix A violated the federal securities laws, admits the Commission's jurisdiction over it and the subject matter of these proceedings, and consents to the entry of this Order Instituting Administrative and Cease-and-Desist Proceedings Pursuant to Sections 203(e) and 203(k) of the Investment Advisers Act of 1940, and Sections 9(b) and 9(f) of the Investment Company Act of 1940, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that:

A. Summary

1. This matter arises from a registered investment adviser's advertising of a materially inflated, and hypothetical and back-tested, performance track record for the period of April 2001 to September 2008 in connection with an exchange-traded fund ("ETF") sector rotation strategy. In September 2008, F-Squared and its co-founder and former CEO Howard Present created an investment strategy they called "AlphaSector" and used data they were at least reckless in not knowing was back-tested to create hypothetical performance of AlphaSector. From September 2008 to September 2013, F-Squared advertised the hypothetical historical performance as "not backtested" and based on an actual strategy that had been used to manage live assets from April 2001 to September 2008.

2. In addition, F-Squared incorrectly applied ETF trend data – which were detecting price momentum – that dictated whether an ETF was in or out of the AlphaSector portfolio (the "in/out signals"). In creating its back-tested track record, F-Squared systematically applied the in/out signals one week before the ETF price changes that caused changes in signals (*i.e.*, a change from invested in the ETF to out of the ETF or vice-versa). As a result, the advertised historical performance of the AlphaSector strategy from April 2001 to September 2008 was based on implementing signals to sell before price drops and to buy before price increases that had occurred a week earlier. F-Squared at least recklessly compiled the historical data to implement a hypothetical trade (that F-Squared advertised as an actual trade) one week before the trade could have occurred.

3. The inaccurate compilation of historical data substantially improved the AlphaSector strategy's advertised hypothetical and back-tested historical performance. If an investor made a hypothetical investment of $100,000 on April 1, 2001 (assuming a reinvestment of dividends and no further contributions or withdrawals), the investment would have been worth approximately $128,000 on August 24, 2008 if invested in the S&P 500 Index. With accurately timed (but still hypothetical and back-tested) signal implementation, the same investment in F-Squared's hypothetical ETF sector rotation strategy would have been worth $138,000. However, by implementing the hypothetical and back-tested signals one week early, F-Squared advertised the investment as worth $235,000 – an increase of approximately 350% more than if F-Squared had applied the signals accurately.

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[1] The findings herein are made pursuant to Respondent's Offer and are not binding on any other person or entity in this or any other proceeding.

4. As described below, virtually all of F-Squared's claimed outperformance relative to the S&P 500 Index for the period before October 2008 is attributable to its data compilation error. By 2014, F-Squared's ETF strategy was the largest in the market, with approximately $28.5 billion in assets following the strategy.

B. Respondent

5. **F-Squared Investments, Inc.** (SEC File No. 801-69937) is an investment adviser registered with the Commission since March 2009 and is headquartered in Wellesley, Massachusetts. In October 2008, F-Squared launched its first AlphaSector index. Today, F-Squared sub-licenses its approximately 75 AlphaSector indexes to unaffiliated third parties who manage assets pursuant to these indexes. As of June 30, 2014, there were approximately $28.5 billion invested pursuant to AlphaSector indexes including $13 billion in mutual fund assets sub-advised by F-Squared.[2] Since June 2010, F-Squared Investments, Inc. has been a wholly-owned subsidiary of F-Squared Investment Management, LLC.

C. Other Relevant Person

6. **Howard Brian Present** ("Present"), age 53, resides in Wellesley, Massachusetts. In 2006, Present co-founded F-Squared. Present was the President and CEO of F-Squared until his separation in 2014. Present owns approximately 22% of F-Squared Investment Management, LLC.

D. Facts

AlphaSector Background

7. From October 2008 to September 2013, F-Squared marketed an ETF sector rotation strategy called AlphaSector that was based on an algorithm that yields a "signal" indicating whether to buy or sell nine industry ETFs.[3] As of June 30, 2014, there was approximately $28.5 billion

[2] In August 2010, F-Squared Institutional Advisors, LLC (SEC File No. 801-71753), a registered investment adviser and an affiliate of F-Squared Investments, Inc., was created and became the sub-adviser of the registered mutual funds.

[3] F-Squared has created several AlphaSector strategies and sub-licenses approximately 75 AlphaSector indexes. The AlphaSector indexes that are the subject of this matter, including the AlphaSector Premium Index and the AlphaSector Rotation Index, are based on investments in U.S. Equity ETFs. As with all indexes, the performance of the AlphaSector Premium and AlphaSector Rotation indexes are inherently hypothetical in the sense that the index does not purport to reflect the performance of any particular client or account. However, as described below, F-Squared advertised that the AlphaSector Premium Index and AlphaSector Rotation Index were based on a strategy that had been in place since 2001 and therefore the performance of these indexes was "not backtested" when in fact the performance *was* backtested.

invested pursuant to the AlphaSector indexes. The bulk of these assets are invested through registered mutual funds or other funds or through separately managed accounts managed by advisers or brokers who implement the strategy based on information they receive periodically from F-Squared. Today, AlphaSector is the largest active ETF strategy in the market.

8. F-Squared and Present began advertising the AlphaSector strategy via an index in September 2008. From inception, F-Squared stated in advertisements that AlphaSector is an ETF sector rotation strategy that (i) invests in as many as nine U.S. equities industry ETFs, with an algorithm or quantitative engine determining whether, based on ETF sector trends and volatility, the portfolio would invest in none, some, or all of the nine ETFs; (ii) holds equal ownership of any of the nine ETFs with a positive trend and no ownership of any of the nine ETFs with a negative or neutral trend; (iii) rebalances periodically, either weekly or monthly, and only when at least one of the nine ETFs show a change in trend; and (iv) applies a 25% cap per ETF (*i.e.*, no ETF would hold more than 25% of the total assets in the strategy) at the time of rebalancing, with the remainder of the portfolio invested in a short-term treasury ETF (representing cash).

9. Present created and was responsible for all of F-Squared's AlphaSector advertisements, which included PowerPoint presentations describing the strategy and its past performance, including for the period April 2001 to September 2008. The relevant slides from F-Squared's August 2013 standard presentation for the AlphaSector Premium Index, which was available on F-Squared's public website until the end of September 2013, are attached as Exhibit 1. F-Squared posted the presentations and other AlphaSector performance advertisements and marketing materials on its public website and sent them to numerous prospective and current clients from September 2008 to September 2013.

10. From AlphaSector's inception in October 2008 through September 2013, F-Squared advertised AlphaSector's past performance as index performance. Even though F-Squared did not create AlphaSector until late 2008, F-Squared made two materially false claims in its AlphaSector advertisements and Forms ADV, namely that:

- the in/out ETF signals that formed the basis of the AlphaSector index returns had been used to manage client assets from April 2001 to September 2008; and

- the in/out ETF signals resulted in a track record that significantly outperformed the S&P 500 Index from April 2001 to September 2008.

F-Squared was at least reckless in advertising both of these statements.

<u>F-Squared and Present Used Back-Tested Data to Create a Seven-Year Track Record</u>

11. According to Present, in early 2008, Present and a proprietor of a private wealth advisory firm (hereinafter, "Private Wealth Advisor") discussed a sector rotation investment strategy using ETFs. According to Present, in the context of these discussions, the Private Wealth Advisor

claimed to have used a sector rotation strategy to manage client assets. Present never saw records showing that the Private Wealth Advisor had invested advisory clients in a sector rotation strategy. Present was encouraged to get such documentation – for instance, in mid-2008, F-Squared's co-founder and former Vice Chairman reports that he told Present to get account records to confirm the historical performance of the Private Wealth Advisor's sector rotation strategy.

12. Present also understood that the Private Wealth Advisor had a college intern who was developing an algorithm to use in conjunction with the sector rotation strategy. The algorithm could generate a momentum-based signal that could be used to determine whether to invest or not invest in a particular sector ETF. As discussions between Present and the Private Wealth Advisor moved forward in summer 2008, the Private Wealth Advisor decided to co-found a signal provider company (the "Data Provider") with his intern. The Data Provider would send data with in/out signals to F-Squared that F-Squared would then use to determine whether AlphaSector would own or not own an ETF.

13. In late August and early September 2008, as F-Squared and the Data Provider were finalizing a contract for signal delivery to F-Squared, the Private Wealth Advisor's intern sent Present three sets of hypothetical, back-tested weekly trends for each of the ETFs. A positive trend was a signal to be "in" (buy or own) the ETF, and a negative trend was a signal to be "out" (sell or do not own) of the ETF. The first two data sets of trends were based on whether the simple moving average of each ETF had increased or decreased from the previous week. One of the two sets of trends was based on a 41-week simple moving average and the other set was based on a 61-week simple moving average.[4] The intern's third set of signals were from his own algorithm.

14. After he received the three sets of signals from the Private Wealth Advisor's intern, Present instructed an F-Squared employee to divide the three sets of weekly ETF trend or signal data among three different time periods, which, according to Present, corresponded to the periods the Private Wealth Advisor had claimed each set of signals had been used to manage his clients' assets, and then calculate AlphaSector's back-tested and hypothetical historical performance for the period April 2001 to September 2008. The 61-week simple moving average trends were used for the period April 2001 to June 2006, the 41-week simple moving average trends were used for the period July 2006 to June 2008, and the signals from the intern's algorithm were used for the period July 2008 to September 2008.

15. To convert the in/out ETF signals into an index "track record," F-Squared and Present tested the performance of various portfolio construction methodologies – which convert the ETF

[4] In this instance, the simple moving average is the sum of the weekly closing prices of an ETF for either 41 or 61 weeks divided by either 41 or 61. The trends the intern sent Present showed each ETF's simple moving average at the end of each week for the period 2001-2008. A positive ETF trend, for example, meant that week's simple moving average for the particular ETF was higher than the prior week's simple moving average.

signals into performance – and ultimately Present created the rules, described in paragraph 8, that are central to the AlphaSector strategy.

16. F-Squared's AlphaSector advertisements emphasized algorithmic-based models that purportedly supported both the hypothetical and actual track record beginning in July 2008, but in reality the AlphaSector track record for the period April 2001 to June 2008 was based on changes in 41-week and 61-week simple moving averages. An example of the model description underlying AlphaSector is at page 14 of Exhibit 1.

17. The Private Wealth Advisor never used a sector rotation strategy. His client and customer trades were ad hoc, client-by-client, non-discretionary, and were not uniform across clients. Before mid-2008, the Private Wealth Advisor and his business partner traded the ETFs that form the basis of AlphaSector only infrequently, and they did not trade some of the ETFs at all. To the extent that the Private Wealth Advisor ever attempted to use moving average data to make trades, the trades were not consistent with the trend data F-Squared and Present used to create AlphaSector's performance.

F-Squared and Present Ignored a Material Performance Calculation Error

18. F-Squared created the pre-October 2008 "historical track record" incorrectly by implementing all the purchases and sales dictated by the ETF trend signals one week before they should have been implemented. Because the signals were detecting price momentum, F-Squared's incorrectly implementing the signals one week early meant that AlphaSector's "historical track record" was based on its selling before price drops that had already occurred and buying before price increases that had already occurred. As described below, virtually all of AlphaSector's claimed outperformance relative to the S&P 500 Index for the pre-October 2008 period is attributable to this erroneous calculation.

19. The now former F-Squared employee who constructed the AlphaSector track record realized the error by late September 2008, shortly after F-Squared started advertising the strategy, and alerted Present. Nevertheless, F-Squared and Present continued to advertise the inflated track record until September 2013.

20. The inaccurate compilation of historical data substantially improved the AlphaSector's strategy's advertised back-tested and hypothetical historical performance for the pre-October 2008 period. If an investor made a hypothetical investment of $100,000 on April 1, 2001 (assuming a reinvestment of dividends and no further contributions or withdrawals), the investment would have been worth approximately $128,000 on August 24, 2008 if invested in the S&P 500 Index. With accurately timed (but still hypothetical and back-tested) signal implementation, the same investment in F-Squared's hypothetical ETF sector rotation strategy would have been worth $138,000. However, by implementing the hypothetical and back-tested signals one week early, F-Squared advertised the investment as worth $235,000.

After 2008, Present and F-Squared Continued to Advertise AlphaSector's Hypothetical and Back-Tested and Substantially Improved Track Record

21. On multiple occasions after September 2008, Present requested back-up documentation from the Private Wealth Advisor to support AlphaSector's track record. Present never received back-up from the Private Wealth Advisor. Despite the lack of documentation of live assets supporting AlphaSector's performance for the period prior to September 2008, F-Squared and Present continued to advertise the false track record until September 2013.

22. In January 2009, Present contacted the Private Wealth Advisor and his business partner to obtain an audited track record for the Private Wealth Advisor's accounts that had supposedly tracked the AlphaSector methodology. Present did not receive one. During these discussions, the Private Wealth Advisor told Present that the Private Wealth Advisor did not have a specific track record because he considered the sector rotation strategy to be a client-by-client trading strategy and not a specific product.

23. In October 2009, F-Squared began sub-advising mutual funds using the AlphaSector strategies. In connection with that effort, Present assured the mutual fund adviser that AlphaSector's performance was constructed based on "actual investment philosophy, trading patterns and portfolio strategy that was employed for the client assets." Present stated that the portfolio construction rules used to create AlphaSector were all "consistent elements of the AlphaSector Strategy during its entire existence, and critical to its performance returns." Present also stated that the AlphaSector Index was "based on investment decisions that were generated on a live basis since 2001" and "the Index therefore explicitly does not reflect backtested data, but instead represents live, historical data." The mutual fund adviser, working with Present, amended the funds' prospectus to include the inflated historical performance of the AlphaSector indexes from April 2001 to September 2008.

24. In June 2012, F-Squared retained an outside attorney to perform a mock audit. One of the recommendations from the mock audit was that F-Squared "should ensure that it has books and records to support its performance disclosed for years prior to the year 2006." Present sent several communications in June and July 2012 to the Private Wealth Advisor and officers of the Data Provider co-founded by the Private Wealth Advisor in 2008, seeking the required records. F-Squared's then-CCO also prepared a document by which the Data Provider and/or the Private Wealth Advisor would certify that they had records to support the advertised historical performance. These efforts proved unsuccessful. Present's effort to elicit information from the Data Provider also prompted the Data Provider's CEO and COO to tell Present that: (i) the Private Wealth Advisor's former intern (now the Chief Technology Officer (CTO) of the Data Provider) was only 14 years old in 2001; and (ii) the data the former intern sent Present would have been back-tested for the period before either 2007 or 2008, when the former intern started working on the algorithm.

25. In October 2012, Present received a copy of a September 2008 email from a then F-Squared employee to a then employee of the Private Wealth Advisor concerning the implementation of historical signals. That email concerned the dating convention associated with the Data Provider's

signals and should have called into question whether F-Squared implemented the signals one week early in creating AlphaSector's pre-October 2008 track record. Nonetheless, Present and F-Squared continued to advertise that inflated track record.

26. By May 2013, F-Squared had decided to replace the Data Provider's ETF signals with signals generated by its own proprietary model. During this process, the Data Provider's CEO and CTO told Present that the Private Wealth Advisor was not responsible for F-Squared's pre-October 2008 track record. In addition, on July 1, 2013, the Data Provider's CEO and CTO told Present that they could not replicate AlphaSector's pre-October 2008 advertised performance when they used the signals they understood were the basis of the AlphaSector track record. In September 2013, F-Squared removed all performance track records and advertising materials for the time period April 2001 to September 2008 from its website.

F-Squared's Inaccurate Advertisements

27. F-Squared's advertisements stated that the inception date of the AlphaSector indices "is based on an active strategy with an inception date of April 2001. Inception date is defined as the date as of which investor assets began tracking the strategy." This disclosure is located in Exhibit 1 at page 18.

28. Starting in late 2009, F-Squared's AlphaSector advertisements also explicitly claimed that the track record for the period April 2001 to September 2008 was not back-tested. For example, even as of September 2013, F-Squared's advertisements stated: "The process of converting the active strategy to an index implies that the returns presented, while not backtested, reflect theoretical performance an investor would have obtained had it invested in the manner shown and does not represent returns that an investor actually attained, as investors cannot invest directly in an index." This disclosure is located in Exhibit 1 at page 18.

29. From September 2008 to September 2013, F-Squared advertised that AlphaSector indices had outperformed the S&P 500 Index, particularly for the period from April 2001 to September 2008. Attached at pages 10 and 11 of Exhibit 1 are examples of AlphaSector performance advertisements.

30. F-Squared also claimed that it was responsible for AlphaSector's buy and sell decisions for the pre-October 2008 period. For example, in September 2013, F-Squared's public website featured news articles with statements such as:

- "Back in mid-2007, well before the financial debacle that began with the collapse of the investment bank Bear Stearns, Howard Present, co-founder, president and CEO of F-Squared Investments in Boston, had a strategy that determined that financial stocks were becoming too risky. But they didn't just sell down the financial holdings, which at the time represented one-ninth of his strategy's investments. He sold *all* his financial holdings."

- "We eventually dropped the tech sector in 2001," says Present.

- "Financials in 2006, [Present] notes, had moved from a historic average of about 15% of the S&P to 28%, or nearly double, which was another sign of a bubble that F-Squared was able to avoid. . . And when [Financials] started to show signs of decline, F-Squared dropped its entire financials allocation like a hot potato."

F-Squared's Inaccurate Forms ADV

31. F-Squared's various Forms ADV filed during the period October 2008 to September 2013 inaccurately claimed that the investment models underlying the index had been used to manage actual client assets between April 2001 and September 2008.

F-Squared's Policies and Procedures Were Inadequately Designed and Implemented

32. During the October 2008 to October 2013 time period, F-Squared failed to adopt and implement policies reasonably designed to prevent violations of the Advisers Act and its rules. For example, F-Squared did not have policies reasonably designed to prevent the use of performance advertising materials that were false or misleading. Furthermore, F-Squared published performance advertisements without back-up for the performance, even after the issue was identified in a mock audit in 2012.

E. Violations

33. Based on the conduct described above, Respondent willfully[5] violated Section 206(1) of the Advisers Act, which prohibits any investment adviser from employing any device, scheme, or artifice to defraud any client or prospective client.

34. Based on the conduct described above, Respondent willfully violated Section 206(2) of the Advisers Act, which prohibits any investment adviser from engaging in any transaction, practice, or course of business which operates as a fraud or deceit upon any client or prospective client.

35. Based on the conduct described above, Respondent willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-1(a)(5) thereunder, which makes it a fraudulent, deceptive, or

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[5] A willful violation of the securities laws means merely "'that the person charged with the duty knows what he is doing.'" Wonsover v. SEC, 205 F.3d 408, 414 (D.C. Cir. 2000) (quoting Hughes v. SEC, 174 F.2d 969, 977 (D.C. Cir. 1949)). There is no requirement that the actor "'also be aware that he is violating one of the Rules or Acts.'" Id. (quoting Gearhart & Otis, Inc. v. SEC, 348 F.2d 798, 803 (D.C. Cir. 1965)).

manipulative act, practice, or course of business within the meaning of Section 206(4) of the Advisers Act to, among other things, directly or indirectly publish, circulate, or distribute an advertisement which contains any untrue statement of material fact, or which is otherwise false or misleading.

36. Based on the conduct described above, Respondent willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-7 thereunder, which, among other things, makes it a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of Section 206(4) of the Advisers Act to fail to adopt and implement such written policies or procedures reasonably designed to prevent violation of the Advisers Act and the rules promulgated thereunder.

37. Based on the conduct described above, Respondent willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-8 thereunder, which makes it a fraudulent, deceptive, or manipulative act, practice, or course of business within the meaning of Section 206(4) of the Advisers Act for any investment adviser to a pooled vehicle to make any untrue statement of a material fact or to omit to state a material fact necessary to make the statements made, in light of the circumstances under which they were made, not misleading, to any investor or prospective investor in the pooled investment vehicle, or to other wise engage in any act, practice, or course of business that is fraudulent, deceptive or manipulative with respect to any investor or prospective investor in the pooled investment vehicle.

38. Based on the conduct described above, Respondent willfully violated Section 207 of the Advisers Act which makes it unlawful for any person willfully to make any untrue statement of a material fact in any registration application or report filed with the Commission, or willfully to omit to state in any such application or report any material fact which is required to be stated therein.

39. Based on the conduct described above, Respondent willfully violated Section 204 of the Advisers Act and Rule 204-2(a)(16) thereunder. Section 204 of the Advisers Act requires investment advisers to make and keep certain records as the Commission, by rule, may prescribe as necessary or appropriate in the public interest or for the protection of investors. Rule 204-2 under the Advisers Act requires investment advisers registered or required to be registered to make and keep true, accurate and current various books and records relating to their investment advisory business, including all accounts, books, internal working papers, and any other records or documents that are necessary to form the basis for or demonstrate the calculation of the performance or rate of return of any or all managed accounts or securities recommendations in any notice, circular, advertisement, newspaper article, investment letter, bulletin or other communication that the investment adviser circulates or distributes, directly or indirectly, to 10 or more persons.

40. Based on the conduct described above, Respondent willfully aided and abetted and caused certain mutual funds sub-advised by F-Squared to violate Section 34(b) of the Investment Company Act which, among other things, makes it unlawful for any person to make any untrue or misleading statement of material fact in any registration statement, application, report, account, record, or other document filed with the Commission under the Investment Company Act.

F. Respondent's Remedial Efforts and Cooperation

41. In determining to accept Respondent's Offer, the Commission considered the remedial acts undertaken by Respondent and Respondent's cooperation with the Commission staff in its investigation of this matter. Among other things, F-Squared hired an Independent Compliance Consultant in January 2014, and separated its Chief Executive Officer (Howard Present) in 2014. The Independent Compliance Consultant has already undertaken and completed a review of F-Squared's compliance policies and procedures and submitted a report (the "Initial Report") to F-Squared and the Commission staff.

G. Undertakings

42. Independent Compliance Consultant. F-Squared retained the services of an Independent Compliance Consultant in January 2014, and the Independent Compliance Consultant submitted an Initial Report to the Commission staff in September 2014. F-Squared undertakes to maintain the engagement of the Independent Compliance Consultant as follows:

a. Within 30 days of the date of the issuance of this Order, F-Squared shall retain the services of the Independent Compliance Consultant who submitted the Initial Report. The Independent Compliance Consultant's compensation and expenses shall be borne exclusively by F-Squared. F-Squared shall require the Independent Compliance Consultant to conduct a second review of the F-Squared compliance policies and procedures that the Independent Compliance Consultant deems relevant with respect to the creation, publication, circulation, or distribution of performance advertisements or other marketing material;

b. At the end of the review, which in no event shall be more than three months after the date of the issuance of this Order, F-Squared shall require the Independent Compliance Consultant to submit a Second Report to F-Squared and to the Commission staff. The Second Report shall describe the review performed, the conclusions reached, and shall include any recommendations deemed necessary to make the policies and procedures adequate. F-Squared may suggest an alternative procedure designed to achieve the same objective or purpose as that of the recommendation of the Independent Compliance Consultant. The Independent Compliance Consultant shall evaluate any alternative procedure proposed by F-Squared. However, F-Squared shall abide by the Independent Compliance Consultant's final recommendation;

c. Within six months after the date of issuance of this Order, F-Squared shall, in writing, advise the Independent Compliance Consultant and the Commission staff of the recommendations it is adopting;

d. Within nine months after the date of issuance of this Order, F-Squared shall require the Independent Compliance Consultant to complete its review and submit a written final report to Commission staff. The Final Report shall describe the review made of F-Squared's compliance policies and procedures relating to the publication, circulation, or distribution of performance advertisements or other marketing material containing historical (hypothetical or actual) performance information; set forth the conclusions reached and the recommendations made by the Independent Compliance Consultant, as well as any proposals made by F-Squared; and describe how F-Squared is implementing the Independent Compliance Consultant's final recommendations;

e. F-Squared shall take all necessary and appropriate steps to adopt and implement all recommendations contained in the Independent Compliance Consultant's Final Report;

f. For good cause shown and upon timely application by the Independent Compliance Consultant or F-Squared, the Commission's staff may extend any of the deadlines set forth in these undertakings;

g. F-Squared shall require the Independent Compliance Consultant to enter into an agreement providing that for the period of the engagement and for a period of two years from completion of the engagement, the Independent Compliance Consultant shall not enter into any employment, consultant, attorney-client, auditing or other professional relationship with F-Squared, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such. The agreement will also provide that the Independent Compliance Consultant will require that any firm with which he/she is affiliated or of which he/she is a member, and any person engaged to assist the Independent Compliance Consultant in the performance of his or her duties under this Order shall not, without prior written consent of the Commission staff, enter into any employment, consultant, attorney-client, auditing or other professional relationship with F-Squared, or any of its present or former affiliates, directors, officers, employees, or agents acting in their capacity as such for the period of the engagement and for a period of two years after the engagement.

43. F-Squared shall certify, in writing, compliance with the undertakings set forth above. The certification shall identify the undertakings, provide written evidence of compliance in the form of a narrative, and be supported by exhibits sufficient to demonstrate compliance. The Commission's staff may make reasonable requests for further evidence of compliance, and F-Squared agrees to provide such evidence. The certification and supporting material shall be submitted to Kevin M. Kelcourse, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, Suite 2300, Boston, MA 02110, with a copy to the Office of the Chief Counsel of the Enforcement Division, no later than sixty days from the date of completion of the undertakings.

44. Respondent shall cooperate fully with the Commission in any and all investigations, litigations or other proceedings relating to or arising from the matters described in the Order. In connection with such cooperation, Respondent shall: (i) produce, without service of a notice or subpoena, any and all non-privileged documents and other information requested by the Commission staff subject to any restrictions under the law of any foreign jurisdiction; (ii) use its best efforts to cause their officers, employees, and directors to be interviewed by the Commission staff at such time as the staff reasonably may direct; and (iii) use its best efforts to cause their officers, employees, and directors to appear and testify without service of a notice or subpoena in such investigations, depositions, hearings or trials as may be requested by the Commission staff.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent's Offer.

Accordingly, pursuant to Sections 203(e) and 203(k) of the Advisers Act and Sections 9(b) and 9(f) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent shall cease and desist from committing or causing any violations and any future violations of Sections 204(a), 206(1), 206(2), 206(4), 207 of the Advisers Act and Rules 204-2(a)(16), 206(4)-1, 206(4)-7, and 206(4)-8 thereunder and Section 34(b) of the Investment Company Act.

B. F-Squared Investments, Inc. is censured.

C. F-Squared Investments, Inc. shall, within 10 days of the entry of this Order, pay disgorgement of $30 million ($30,000,000.00) to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to SEC Rule of Practice 600. Payment must be made in one of the following ways:

(1) F-Squared Investments, Inc. may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) F-Squared Investments, Inc. may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) F-Squared Investments, Inc. may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169 17

Payments by check or money order must be accompanied by a cover letter identifying F-Squared Investments, Inc. as the Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Kevin M. Kelcourse, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, Suite 2300, Boston, MA 02110.

D. F-Squared Investments, Inc. shall, within 10 days of the entry of this Order, pay a civil money penalty in the amount of $5 million ($5,000,000.00) to the United States Treasury. If timely payment is not made, additional interest shall accrue pursuant to 31 U.S.C. 3717. Payment must be made in one of the following ways:

(1) F-Squared Investments, Inc. may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) F-Squared Investments, Inc. may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) F-Squared Investments, Inc. may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169 17

Payments by check or money order must be accompanied by a cover letter identifying F-Squared Investments, Inc. as the Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Kevin M. Kelcourse, Boston Regional Office, Securities and Exchange Commission, 33 Arch Street, Suite 2300, Boston, MA 02110.

E. Respondent F-Squared Investments, Inc. shall comply with the undertakings enumerated in Section III.G. above.

By the Commission.

Brent J. Fields
Secretary

Jill M. Peterson

By: Jill M. Peterson
Assistant Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File No.

In the Matter of F-SQUARED INVESTMENTS, INC. Respondent.	APPENDIX A TO ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(e) AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, AND SECTIONS 9(b) AND 9(f) OF THE INVESTMENT COMPANY ACT OF 1940, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER

APPENDIX A

Respondent F-Squared Investments, Inc., admits the facts set forth below (the "Admissions") and acknowledges that its conduct violated the federal securities laws:

AlphaSector Background

1. From October 2008 to September 2013, F-Squared marketed an ETF sector rotation strategy called AlphaSector that was based on an algorithm that yields a "signal" indicating whether to buy or sell nine industry ETFs. As of June 30, 2014, there was approximately $28.5 billion invested pursuant to the AlphaSector indexes. The bulk of these assets are invested through registered mutual funds or other funds or through separately managed accounts managed by advisers or brokers who implement the strategy based on information they receive periodically from F-Squared. Today, AlphaSector is the largest active ETF strategy in the market.

2. F-Squared and Present began advertising the AlphaSector strategy via an index in September 2008. From inception, F-Squared stated in advertisements that AlphaSector is an ETF sector rotation strategy that (i) invests in as many as nine U.S. equities industry ETFs, with an algorithm or quantitative engine determining whether, based on ETF sector trends and volatility, the portfolio would invest in none, some, or all of the nine ETFs; (ii) holds equal ownership of any of the nine ETFs with a positive trend and no ownership of any of the nine ETFs with a negative or neutral trend; (iii) rebalances periodically, either weekly or monthly, and only when at least one of the nine ETFs show a change in trend; and (iv) applies a 25% cap per ETF (*i.e.*, no ETF would hold more than 25% of the total assets in the strategy) at the time of rebalancing, with the remainder of the portfolio

invested in a short-term treasury ETF (representing cash).

3. Present created and was responsible for all of F-Squared's AlphaSector advertisements, which included PowerPoint presentations describing the strategy and its past performance, including for the period April 2001 to September 2008. The relevant slides from F-Squared's August 2013 standard presentation for the AlphaSector Premium Index, which was available on F-Squared's public website until the end of September 2013, are attached as Exhibit 1. F-Squared posted the presentations and other AlphaSector performance advertisements and marketing materials on its public website and sent them to numerous prospective and current clients from September 2008 to September 2013.

4. From AlphaSector's inception in October 2008 through September 2013, F-Squared advertised AlphaSector's past performance as index performance. Even though F-Squared did not create AlphaSector until late 2008, F-Squared made two materially false claims in its AlphaSector advertisements and Forms ADV, namely that:

- the in/out ETF signals that formed the basis of the AlphaSector index returns had been used to manage client assets from April 2001 to September 2008; and

- the in/out ETF signals resulted in a track record that significantly outperformed the S&P 500 Index from April 2001 to September 2008.

F-Squared was at least reckless in advertising both of these statements.

<u>F-Squared and Present Used Back-Tested Data to Create a Seven-Year Track Record</u>

5. According to Present, in early 2008, Present and a proprietor of a private wealth advisory firm (hereinafter, "Private Wealth Advisor") discussed a sector rotation investment strategy using ETFs. According to Present, in the context of these discussions, the Private Wealth Advisor claimed to have used a sector rotation strategy to manage client assets. Present never saw records showing that the Private Wealth Advisor had invested advisory clients in a sector rotation strategy.

6. Present also understood that the Private Wealth Advisor had a college intern who was developing an algorithm to use in conjunction with the sector rotation strategy. The algorithm could generate a momentum-based signal that could be used to determine whether to invest or not invest in a particular sector ETF. As discussions between Present and the Private Wealth Advisor moved forward in summer 2008, the Private Wealth Advisor decided to co-found a signal provider company (the "Data Provider") with his intern. The Data Provider would send data with in/out signals to F-Squared that F-Squared would then use to determine whether AlphaSector would own or not own an ETF.

7. In late August and early September 2008, as F-Squared and the Data Provider were finalizing a contract for signal delivery to F-Squared, the Private Wealth Advisor's intern sent Present three sets of hypothetical, back-tested weekly trends for each of the ETFs. A positive trend was a signal to be "in" (buy or own) the ETF, and a negative trend was a signal to be "out" (sell or do not own) of the ETF. The first two data sets of trends were based on whether the simple moving average of each ETF had increased or decreased from the previous week. One of the two sets of trends was based on a 41-week simple moving average and the other set was based on a 61-week simple moving average.[6] The intern's third set of signals were from his own algorithm.

8. After he received the three sets of signals from the Private Wealth Advisor's intern, Present instructed an F-Squared employee to divide the three sets of weekly ETF trend or signal data among three different time periods, which, according to Present, corresponded to the periods the Private Wealth Advisor had claimed each set of signals had been used to manage his clients' assets, and then calculate AlphaSector's back-tested and hypothetical historical performance for the period April 2001 to September 2008. The 61-week simple moving average trends were used for the period April 2001 to June 2006, the 41-week simple moving average trends were used for the period July 2006 to June 2008, and the signals from the intern's algorithm were used for the period July 2008 to September 2008.

9. To convert the in/out ETF signals into an index "track record," F-Squared and Present tested the performance of various portfolio construction methodologies – which convert the ETF signals into performance – and ultimately Present created the rules, described in paragraph 2, that are central to the AlphaSector strategy.

10. F-Squared's AlphaSector advertisements emphasized algorithmic-based models that purportedly supported both the hypothetical and actual track record beginning in July 2008, but in reality the AlphaSector track record for the period April 2001 to June 2008 was based only on changes in 41-week and 61-week simple moving averages. An example of the model description underlying AlphaSector is at page 14 of Exhibit 1.

11. The Private Wealth Advisor never used a sector rotation strategy. His client and customer trades were ad hoc, client-by-client, non-discretionary, and were not uniform across clients. Before mid-2008, the Private Wealth Advisor and his business partner traded the ETFs that form the basis of AlphaSector only infrequently, and they did not trade some of the ETFs at all. To the extent that the Private Wealth Advisor ever attempted to use moving average data to make trades, the trades were not consistent with the trend data F-Squared and Present used to create AlphaSector's performance.

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[1] In this instance, the simple moving average is the sum of the weekly closing prices of an ETF for either 41 or 61 weeks divided by either 41 or 61. The trends the intern sent Present showed each ETF's simple moving average at the end of each week for the period 2001-2008. A positive ETF trend, for example, meant that week's simple moving average for the particular ETF was higher than the prior week's simple moving average.

The Track Record Contained a Substantial Performance Calculation Error

12. F-Squared created the pre-October 2008 "historical track record" incorrectly by implementing all the purchases and sales dictated by the ETF trend signals one week before they should have been implemented. Because the signals were detecting price momentum, F-Squared's incorrectly implementing the signals one week early meant that AlphaSector's "historical track record" was based on its selling before price drops that had already occurred and buying before price increases that had already occurred. As described below, virtually all of AlphaSector's claimed outperformance relative to the S&P 500 Index for the pre-October 2008 period is attributable to this erroneous calculation.

13. The inaccurate compilation of historical data substantially improved the AlphaSector's strategy's advertised back-tested and hypothetical historical performance for the pre-October 2008 period. If an investor made a hypothetical investment of $100,000 on April 1, 2001 (assuming a reinvestment of dividends and no further contributions or withdrawals), the investment would have been worth approximately $128,000 on August 24, 2008 if invested in the S&P 500 Index. With accurately timed (but still hypothetical and back-tested) signal implementation, the same investment in F-Squared's hypothetical ETF sector rotation strategy would have been worth $138,000. However, by implementing the hypothetical and back-tested signals one week early, F-Squared advertised the investment as worth $235,000.

After 2008, Present and F-Squared Continued to Advertise AlphaSector's Hypothetical and Back-Tested and Substantially Improved Track Record

14. On multiple occasions after September 2008, Present requested back-up documentation from the Private Wealth Advisor to support AlphaSector's track record. Present never received back-up from the Private Wealth Advisor. Despite the lack of documentation of live assets supporting AlphaSector's performance for the period prior to September 2008, F-Squared and Present continued to advertise the false track record until September 2013.

15. In January 2009, Present contacted the Private Wealth Advisor and his business partner to obtain an audited track record for the Private Wealth Advisor's accounts that had supposedly tracked the AlphaSector methodology. Present did not receive one. During these discussions, the Private Wealth Advisor told Present that the Private Wealth Advisor did not have a specific track record because he considered the sector rotation strategy to be a client-by-client trading strategy and not a specific product.

16. In October 2009, F-Squared began sub-advising mutual funds using the AlphaSector strategies. In connection with that effort, Present assured the mutual fund adviser that AlphaSector's performance was constructed based on "actual investment philosophy, trading patterns and portfolio strategy that was employed for the client assets." Present stated that the portfolio construction rules used to create AlphaSector were all "consistent elements of the AlphaSector Strategy during its entire existence, and critical to its performance returns." Present also stated that the AlphaSector Index was

"based on investment decisions that were generated on a live basis since 2001" and "the Index therefore explicitly does not reflect backtested data, but instead represents live, historical data." The mutual fund adviser, working with Present, amended the funds' prospectus to include the inflated historical performance of the AlphaSector indexes from April 2001 to September 2008.

17. In June 2012, F-Squared retained an outside attorney to perform a mock audit. One of the recommendations from the mock audit was that F-Squared "should ensure that it has books and records to support its performance disclosed for years prior to the year 2006." Present sent several communications in June and July 2012 to the Private Wealth Advisor and officers of the Data Provider co-founded by the Private Wealth Advisor in 2008, seeking the required records. F-Squared's then-CCO also prepared a document by which the Data Provider and/or the Private Wealth Advisor would certify that they had records to support the advertised historical performance. These efforts proved unsuccessful. Present's effort to elicit information from the Data Provider also prompted the Data Provider's CEO and COO to tell Present that: (i) the Private Wealth Advisor's former intern (now the Chief Technology Officer (CTO) of the Data Provider) was only 14 years old in 2001; and (ii) the data the former intern sent Present would have been back-tested for the period before either 2007 or 2008, when the former intern started working on the algorithm.

18. In October 2012, Present received a copy of a September 2008 email from a then F-Squared employee to a then employee of the Private Wealth Advisor concerning the implementation of historical signals. That email concerned the dating convention associated with the Data Provider's signals and should have called into question whether F-Squared implemented the signals one week early in creating AlphaSector's pre-October 2008 track record. Nonetheless, Present and F-Squared continued to advertise that inflated track record.

19. By May 2013, F-Squared had decided to replace the signal provider company's ETF signals with signals generated by its own proprietary model. On July 1, 2013, Data Provider's CEO and CTO told Present that they could not replicate AlphaSector's pre-October 2008 advertised performance when they used the signals they understood were the basis of the AlphaSector track record. In September 2013, F-Squared removed all performance track records and advertising materials for the time period April 2001 to September 2008 from its website.

<u>F-Squared's Inaccurate Advertisements</u>

20. F-Squared's advertisements stated that the inception date of the AlphaSector indices "is based on an active strategy with an inception date of April 2001. Inception date is defined as the date as of which investor assets began tracking the strategy." This disclosure is located in Exhibit 1 at page 18.

21. Starting in late 2009, F-Squared's AlphaSector advertisements also explicitly claimed that the track record for the period April 2001 to September 2008 was not back-tested. For example, even as of September 2013, F-Squared's advertisements stated: "The process of converting the active strategy to an index implies that the returns presented, while not backtested, reflect theoretical performance an investor would have obtained had it invested in the manner shown and does not

represent returns that an investor actually attained, as investors cannot invest directly in an index." This disclosure is located in Exhibit 1 at page 18.

22. From September 2008 to September 2013, F-Squared advertised that AlphaSector indices had outperformed the S&P 500 Index, particularly for the period from April 2001 to September 2008. Attached at pages 10 and 11 of Exhibit 1 are examples of AlphaSector performance advertisements.

23. F-Squared also claimed that it was responsible for AlphaSector's buy and sell decisions for the pre-October 2008 period. For example, in September 2013, F-Squared's public website featured news articles with statements such as:

- "Back in mid-2007, well before the financial debacle that began with the collapse of the investment bank Bear Stearns, Howard Present, co-founder, president and CEO of F-Squared Investments in Boston, had a strategy that determined that financial stocks were becoming too risky. But they didn't just sell down the financial holdings, which at the time represented one-ninth of his strategy's investments. He sold *all* his financial holdings."

- "We eventually dropped the tech sector in 2001," says Present.

- "Financials in 2006, [Present] notes, had moved from a historic average of about 15% of the S&P to 28%, or nearly double, which was another sign of a bubble that F-Squared was able to avoid. . . And when [Financials] started to show signs of decline, F-Squared dropped its entire financials allocation like a hot potato."

F-Squared's Inaccurate Forms ADV

24. F-Squared's various Forms ADV filed during the period October 2008 to September 2013 inaccurately claimed that the investment models underlying the index had been used to manage actual client assets between April 2001 and September 2008.

F-Squared's Policies and Procedures Were Inadequately Designed and Implemented

25. During the October 2008 to October 2013 time period, F-Squared failed to adopt and implement policies reasonably designed to prevent violations of the Advisers Act and its rules. For example, F-Squared did not have policies reasonably designed to prevent the use of performance advertising materials were false or misleading. Furthermore, F-Squared published performance advertisements without back-up for the performance, even after the issue was identified in a mock audit in 2012.

Conclusion

26. In connection with the violations described in the foregoing Admissions, F-Squared Investment, Inc.'s actions were, at a minimum, reckless.

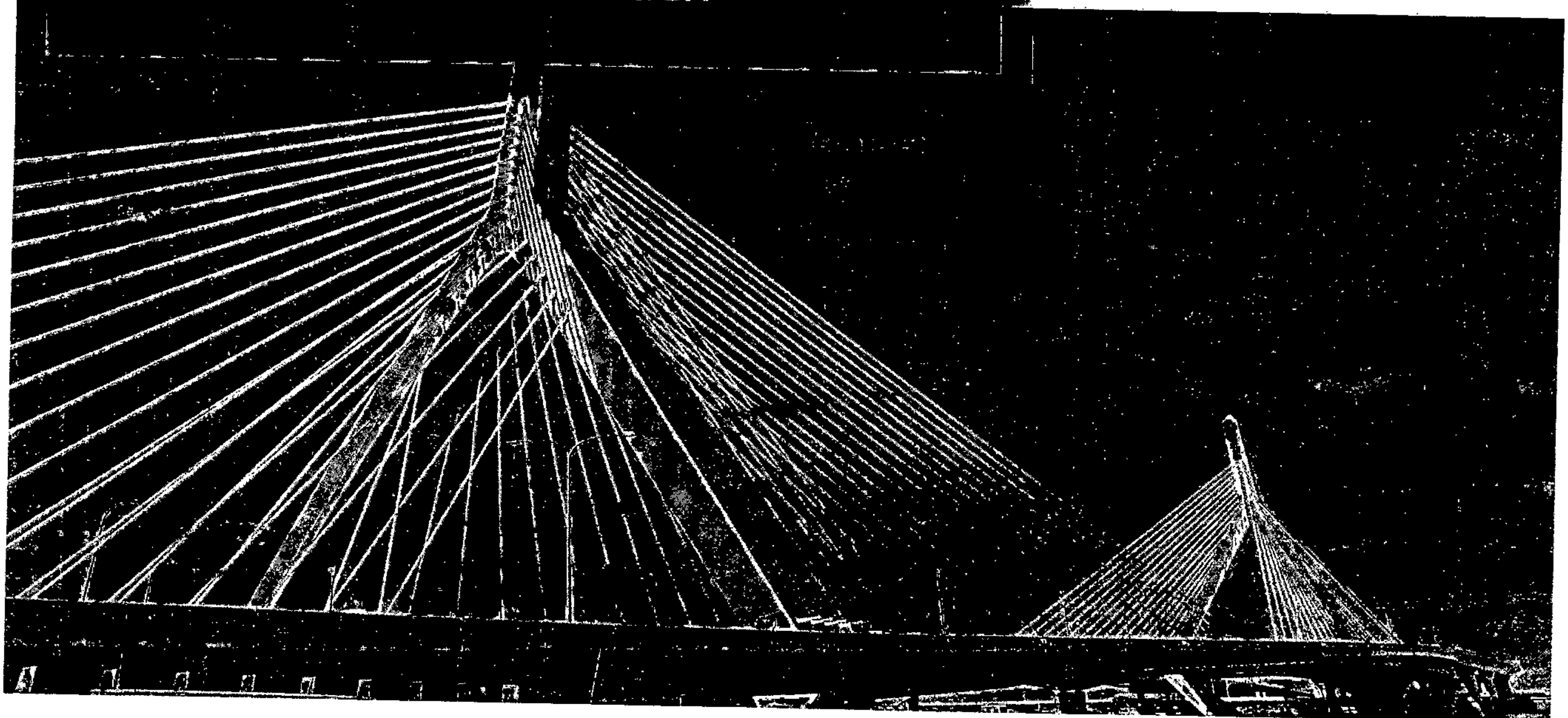
EXHIBIT 1

Strategies Tracking the AlphaSector® Series of Indices:

F-Squared Investments®

Rethink Investing™

AlphaSector Premium Index

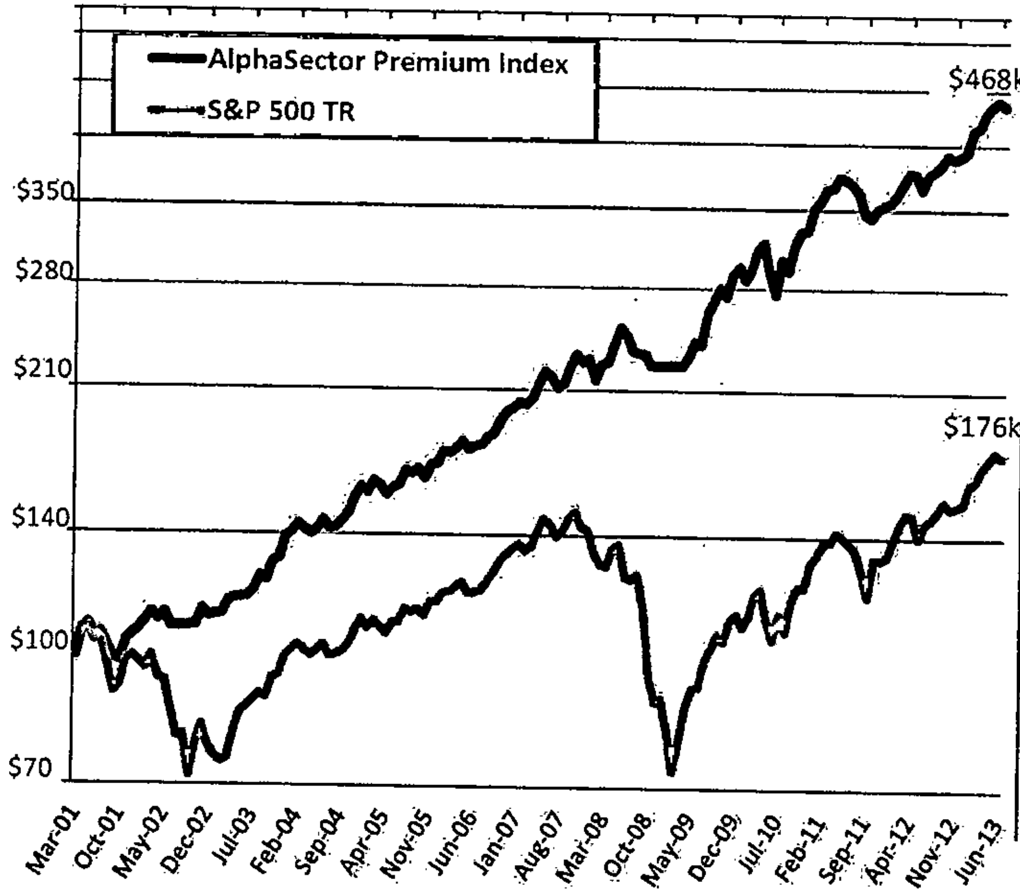


AUGUST 2013

AlphaSector was designed to meet the real needs of investors: risk controls for down markets, participation in up markets[1]

- **Powerful but simple story, and uses NO derivatives, leverage, or shorting**

Growth of $100k: Comparison vs. S&P 500 TR



Source: Morningstar, F-Squared Investments. [1]April 2001– June 2013

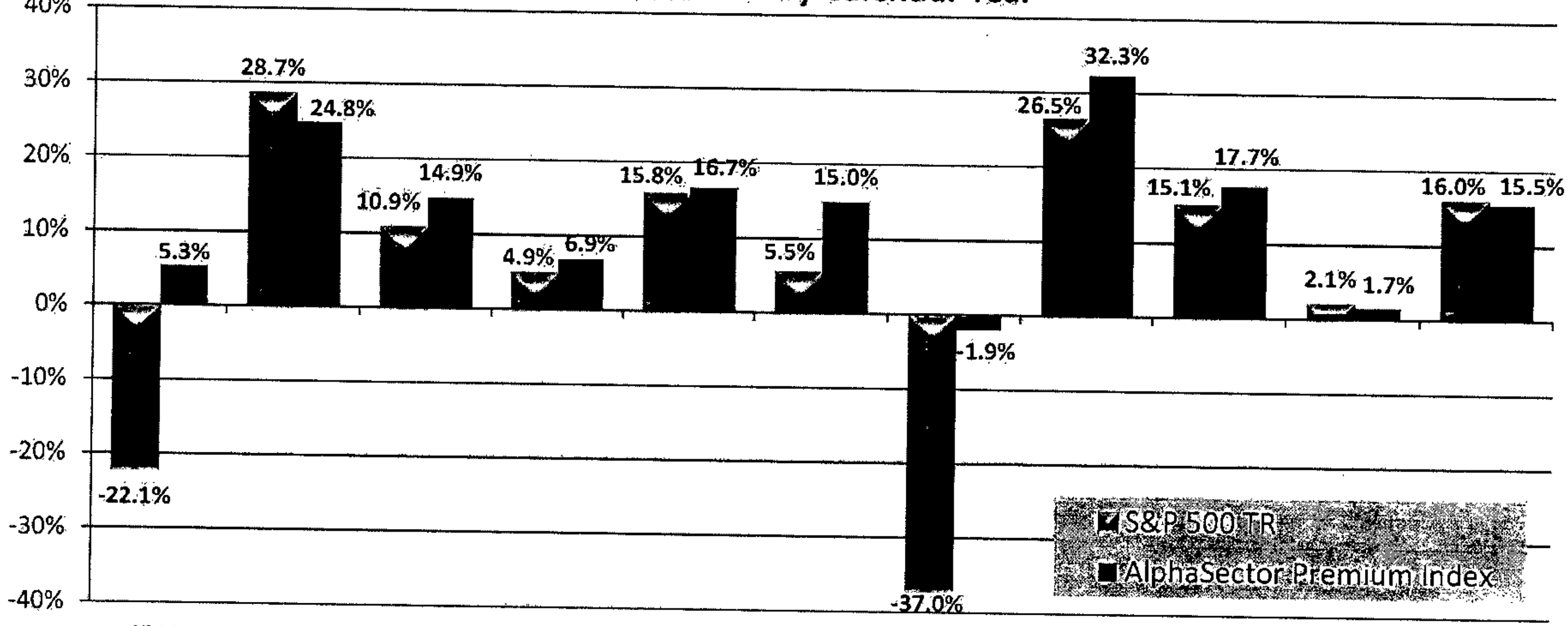
Data as of June 30, 2013

	AlphaSector Premium Index	S&P 500
Cumulative Return	368.2%	76.0%
1 Year Return	21.3%	20.6%
3 Yr Return (Annualized)	19.3%	18.5%
5 Yr Return (Annualized)	13.8%	7.0%
10 Yr Return (Annualized)	14.8%	7.3%
Standard Deviation	10.4%	15.5%
Annual Excess Return	8.7%	N/A
R-Squared	53.0%	N/A
Maximum Drawdown	-13.4%	-51.0%
*ASYMMETRY RATIO**	**70%**	**0%**
Up Capture Ratio(Bull)	85%	0%
Down Capture Ratio (Bear)	15%	0%

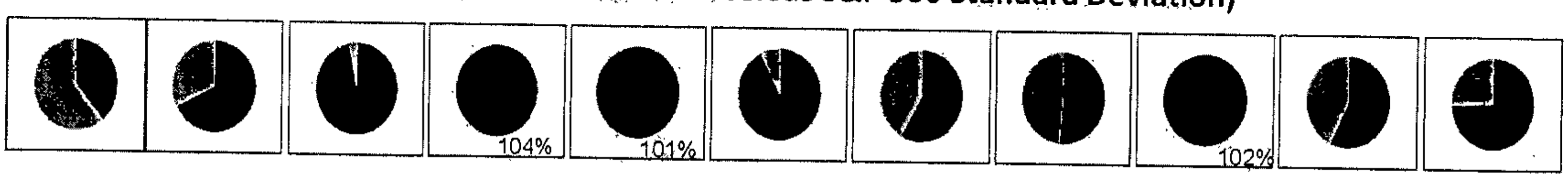
** See final pages for definition of Asymmetry Ratio*

AlphaSector
An F-Squared Solution

AlphaSector Premium Index has historically delivered consistent returns across multiple market cycles[1]



Relative Volatility (Green = API Standard Deviation versus S&P 500 Standard Deviation)



Source: Morningstar, F-Squared Investments. [1]April 2001– December 2012

AlphaSector
An F-Squared Solution

AlphaSector Premium: Construction methodology

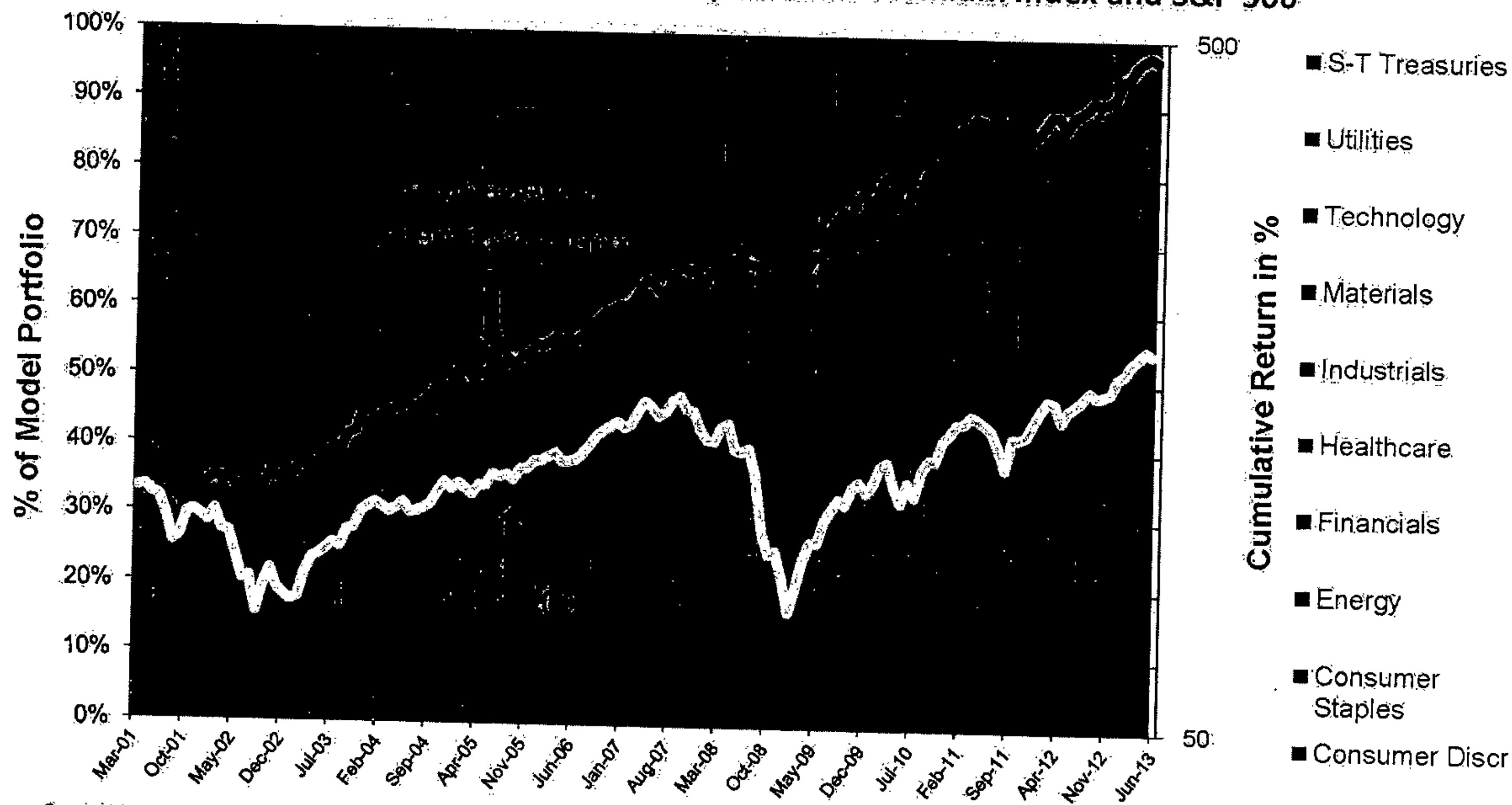
- **Investments include:**
  - Nine exchange traded funds (ETFs) reflecting the primary sectors of the U.S. economy
  - Short-term Treasuries ETF, used for downside protection

Consumer Discr	Consumer Staples	Energy	Financials	Healthcare	Industrials	Materials	Tech	Utilities	S-T Treasury

- **Index is re-evaluated weekly**
- **Sector ETFs are traded using a binary model – either IN or OUT of the portfolio**
  - Sectors forecasted for positive return are left in; sectors forecasted to lose money are removed entirely
  - Decisions are based on a proprietary quantitative model in operation and development since 2001
- **All sectors remaining IN the index are <u>equal weighted</u> at the time of rebalancing**
  - There is a maximum cap of 25% for any sector ETF at time of rebalance
- **When 6 or more sectors are OUT, the model reduces exposure to equities**
  - Begin to build "cash" position using Short-term Treasury ETF:
    3 sectors IN = 25% cash; 2 sectors IN = 50% cash; 1 sector IN = 75% cash
  - Can go to 100% in S-T Treasuries if all 9 sectors are eliminated

AlphaSector Indices periodically decide to either eliminate or include a sector from the Index (binary option)[1]

Historical Monthly Model Allocations
with Cumulative Return of AlphaSector Premium Index and S&P 500



Source: Morningstar, F-Squared Investments. [1]*April 2001– June 2013*

AlphaSector™
An F-Squared Solution

AlphaSector Premium: Model description

- **Model objective**
  - Makes a probabilistic determination of the risk of loss for each component ETF
- **Primary factors**
  - Volatility
    - Volatility trends
    - Rate of change
  - Price momentum
- **Key aspects**
  - Price momentum modified by volatility through use of a "Dynamic Volatility Window"
  - Utilizes intra-day volatility
  - Proprietary volatility measure featuring "True Volatility"
    - Volatility transformed into step function versus traditional rolling measure

[redacted]

Important Information

Past performance is no guarantee of future results.

"AlphaSector®" is a registered trademark of F-Squared Investments, Inc. and is used with permission. This material is proprietary and being provided on a confidential basis, and may not be reproduced, transferred or distributed in any form without prior written permission from F-Squared Investment Management, LLC or one of its subsidiaries (collectively, "F-Squared Investments" or "F-Squared"). F-Squared reserves the right at any time and without notice to change, amend, or cease publication of the Information. This material has been prepared solely for informative purposes. The information contained herein includes information that has been obtained from third party sources and has not been independently verified. It is made available on an "as is" basis without warranty.

Investment products that may be based on AlphaSector Indexes may not be sponsored by F-Squared, and F-Squared does not make any representation regarding the advisability of investing in them. F-Squared serves as the model provider to various investment advisers. There is no guarantee that an investor's account will achieve its objectives or avoid losses. Inclusion of a mutual fund or an exchange traded fund in an index does not in any way reflect an opinion of F-Squared regarding the investment merits of such a fund, nor should it be interpreted as an offer of such a fund's securities. None of the mutual funds or exchange traded funds included in an index has given any real or implied endorsement or support to F-Squared or to this index. One cannot invest directly in an index.

All AlphaSector Indexes represented in this material do not reflect the actual trading of any client account. No representation is being made that any client will or is likely to achieve results similar to those presented herein.

Most AlphaSector Indexes are evaluated for rebalancing on both a monthly basis ("Rotation") or evaluated for rebalancing on a weekly basis ("Premium"). The following is a summary of the core AlphaSector strategies:

The *AlphaSector U.S. Equity Index* is based on an active strategy with an inception date of April 2001. Inception date is defined as the date as of which investor assets began tracking the strategy. Returns provided prior to 2008 were generated from data received under a third party licensing agreement and are provided on an as is basis. The process of converting the active strategy to an index implies that the returns presented, while not backtested, reflect theoretical performance an investor would have obtained had it invested in the manner shown and does not represent returns that an investor actually attained, as investors cannot invest directly in an index.

The *AlphaSector International Index* returns provided herein were restated in August 2013 and therefore returns presented may differ from previously published returns.

The *AlphaSector Global Index* is a blend of two Indexes, AlphaSector U.S. Equity Index and AlphaSector International Index. Both are based on active strategies, with the AlphaSector U.S. Equity Index having an inception date of April 2001 and the AlphaSector International Index having an inception date of May 2009. Any returns shown in the AlphaSector Global Index prior to May 2009 reflect partially backtested, simulated data.

The *AlphaSector Allocator Index* is a blend of four Indexes: AlphaSector U.S. Equity Index ("U.S. Equity"), AlphaSector International Index ("International"), AlphaSector INFInity Index ("Fixed Income"), and AlphaSector Alternatives Index ("Alternatives"). All are based on active strategies, with the U.S. Equity Index having an inception date of April 2001, the International Index having an inception date of May 2009, and the Fixed Income and Alternative Indexes having an inception date of December 2009. Any returns in the AlphaSector Allocator Index shown prior to December 2009 reflect partially backtested, simulated data.

Commissioner Piwowar Not participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73924 / December 23, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31398 / December 23, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16326

In the Matter of Khaled A. Eldaher, Respondent.	ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934, AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Khaled A. Eldaher ("Respondent" or "Eldaher").

II.

After an investigation, the Division of Enforcement alleges that:

A. RESPONDENT

Eldaher, 52 years old, is a resident of Austin, Texas. Eldaher was associated with registered broker-dealer ACAP Financial, Inc. ("ACAP") from February 2011 to December 2013. In December 2013, ACAP terminated Eldaher.

B. ELDAHER'S SELLING AWAY ACTIVITY

In April 2012, while Eldaher was associated with ACAP, he reached an agreement with Efstratios "Elias" D. Argyropoulos ("Argyropoulos"), the principal of Prima Capital Group, Inc. ("Prima"), an entity purporting to sell pre-IPO Facebook shares in the secondary market, by which Eldaher would receive 50% of the mark-up on Facebook shares sold to investors Eldaher successfully solicited. In 2012, Eldaher sold $362,887.50 worth of Facebook shares to twelve investors throughout the country. Eldaher was paid $15,478 by Prima. ACAP did not know about Eldaher's arrangement with Argyropoulos and terminated Eldaher for selling securities other than through ACAP.

C. VIOLATIONS

As a result of the conduct described above, Eldaher willfully violated Section 15(a)(1) of the Exchange Act, which makes it unlawful for a broker or dealer "to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security" unless registered with the Commission in accordance with Section 15(b) of the Exchange Act.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondent an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 15(b) of the Exchange Act including, but not limited to, disgorgement and civil penalties pursuant to Section 21B of the Exchange Act;

C. What, if any, remedial action is appropriate in the public interest against Respondent pursuant to Section 9(b) of the Investment Company Act; and

D. Whether, pursuant to Section 21C of the Exchange Act, Respondent should be ordered to cease and desist from committing or causing violations of and any future violations of Section 15(a)(1) of the Exchange Act, whether Respondent should be ordered to pay a civil penalty pursuant to Section 21B(a) of the Exchange Act, and whether Respondent should be ordered to pay disgorgement pursuant to Sections 21B(e) and 21C(e) of the Exchange Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondent shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondent as provided for in the Commission's Rules of Practice.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73925 / December 23, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31399 / December 23, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16175

In the Matter of **Kenneth C. Meissner,** **James Doug Scott, and** **Mark S. "Mike" Tomich,** **Respondents.**	**ORDER MAKING FINDINGS AND IMPOSING REMEDIAL SANCTIONS AND A CEASE-AND-DESIST ORDER PURSUANT TO SECTIONS 15(b) AND 21C OF THE SECURITIES EXCHANGE ACT OF 1934 AND SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940 AS TO MARK S. "MIKE" TOMICH**

I.

On September 25, 2014, the Securities and Exchange Commission ("Commission") issued an Order Instituting Administrative and Cease-and-Desist Proceedings pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 ("Exchange Act") and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against Mark S. "Mike" Tomich ("Respondent" or "Tomich") (Rel. No. 34-73226).

II.

In connection with these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings, which are admitted, and except as provided herein in Section V, Respondent consents to the entry of this Order Making Findings and Imposing Remedial Sanctions and a Cease-and-Desist Order Pursuant to Sections 15(b) and 21C of the Securities Exchange Act of 1934 and Section 9(b) of the Investment Company Act of 1940 as to Mark S. "Mike Tomich ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds[1] that

SUMMARY

1. This proceeding arises from a multi-million dollar investment scheme orchestrated by Gary Snisky ("Snisky"). From August 2011 to January 2013, Snisky raised approximately $4.3 million from at least 40 investors across at least eight states through the sale of membership interests in Arete, LLC ("Arete") and other LLCs he controlled. Snisky recruited active insurance agents to solicit prospective investors. These salespeople promised investors no-risk, profitable alternatives to traditional annuities by offering investments in government agency bonds that were backed by the full faith and credit of the United States Government. However, Snisky never made any legitimate investments with investor funds. Instead, Snisky misappropriated approximately $2.8 million of investor funds, mostly through cash withdrawals. He also used these funds to pay commissions to the salespeople and for his personal expenditures.

2. One of the salespeople was Tomich, who raised $969,848 from investors to invest with Snisky and received $48,327 in commissions. Tomich directly or indirectly solicited current and prospective insurance clients for investments, advised prospective investors on the specific details and merits of the investments, received transaction-based compensation for bringing in money from investors, and participated at key points in the investment chain. He was not registered with the Commission as a broker or associated with a registered broker-dealer during this time. Accordingly, Tomich violated Section 15(a) of the Exchange Act by effecting transactions as an unregistered broker.

RESPONDENT

3. Tomich, age 73, is a resident of Belmont, Michigan. Since 1982, Tomich has held an insurance producer license in Michigan, and currently holds producer licenses in at least two other states. Tomich held Series 6 and 63 securities licenses from 1987 to 1997, when he voluntarily separated from his last securities firm and the licenses lapsed. Tomich was an investment adviser registered with the state of Michigan through Michigan's Department of Licensing and Regulatory Affairs from 1999 to October 2010, at which time he voluntarily withdrew his registration. In November 2000, Tomich consented to a cease-and-desist order by the Office of Financial and Insurance Services of the Michigan Department of Consumer and Industry Services based on his illegal sales of viatical settlements. Tomich agreed to cease and desist from violations of the Michigan Uniform Securities Act, which included the prohibition against the sale

[1] The findings herein are made pursuant to Respondent's Offer of Settlement and are not binding on any other person or entity in this or any other proceeding.

of unregistered, nonexempt securities and omitting to state material facts in the offer and sale of securities. Tomich paid restitution to his victims and a $2,000 civil penalty.

OTHER RELEVANT PARTIES

4. Snisky, age 46, was a resident of Longmont, Colorado. He was the sole managing member of Arete, along with four pooled investment vehicles which made offerings as a part of his scheme: (1) CMG Offering – 12PO5i, LLC; (2) CMG Offering – 12PO10i, LLC; (3) Summit Offering – 12PO5i, LLC; and (4) Summit Offering – 12PO10i, LLC (collectively "Snisky PIVs").[2] For orchestrating the scheme described herein, Snisky was indicted by a federal grand jury on November 19, 2013 on charges of mail fraud and money laundering. The next day, he was arrested. Additionally, on February 28, 2013, Colorado's Department of Regulatory Agencies, Division of Securities ("DORA") filed a Complaint for Injunctive and Other Relief against Snisky, Colony Capital, Colony Capital Group, Colony Capital Investments, Colony Capital Holdings, and others alleging various violations of the Colorado Securities Act on the basis that Snisky and others carried out a "private equity fund" scheme to defraud dozens of investors of at least $3.2 million. Trial is set for March 2015 in this matter. Furthermore, Snisky formerly held an ownership interest in Arete, Ltd., a/k/a Sky Peak Capital Management (SEC No. 801-77422), a Cheyenne, Wyoming-based investment adviser registered with the Commission.

5. Arete was a Colorado limited liability company with its principal place of business in Longmont, Colorado. Snisky was Arete's sole and managing member. Arete functioned both as the entity through which Snisky engaged in his overall business operations and as the primary issuer, or pooled investment vehicle, whose interests were offered and sold to investors. Snisky formed Arete in June 2011 and voluntarily dissolved the entity in late April 2012. Arete has never registered an offering of securities under the Securities Act of 1933 or a class of securities under the Exchange Act. Arete has never been registered with the Commission in any capacity.

BACKGROUND

6. From August 2011 through January 2013, Snisky offered and sold membership interests in LLCs he created, managed and controlled (Arete, LLC and the Snisky PIVs) to investors across the country. Investors were told that money from their membership purchases in Arete or the Snisky PIVs would be pooled together to purchase government-backed agency bonds.

[2] The Snisky PIVs shared the following characteristics: (1) all had principal place of business in Longmont, CO; (2) Snisky was the sole and managing member of all the entities; (3) all were formed in April 2012 as "placement LLC" or pooled investment vehicle by which investors invested funds for the Arete investment; (4) none of the Snisky PIVs were ever registered as an offering of securities under the Securities Act or as a class of securities under the Exchange Act; and (5) none of the Snisky PIVs have ever been registered with the Commission in any capacity. Although the investment contracts offered by Snisky identified the Snisky PIVs and Arete separately, all of the investors believed they were investing in Arete. Additionally, all investor funds flowed through bank accounts held in Arete's name.

7. Snisky did not personally solicit the investments from the investors. Rather, he recruited and trained veteran insurance salespersons across the country to solicit investments from their current and prospective client bases. Snisky persuaded the salespeople to market and sell the investments by, among other things, showing them fraudulent investor account statements, an Excel-based financial model that calculated "guaranteed returns" based on a given investment amount and provided a print out for investors, and screenshots from a Bloomberg software purportedly showing the bond investments.

8. In order to entice the investors to invest their money in Arete and the Snisky PIVs, Snisky instructed his salespeople to communicate the following information to investors: (1) these investments would purportedly generate a guaranteed annual return of 6% or 7% annually; (2) Snisky could use his status as an "institutional trader" to engage in overnight banking sweeps to generate even larger returns for the investors; (3) investors would receive a 10% bonus to compensate them for any early withdrawal penalties from their existing investments; (4) investors received assurances that their investments would be "safe" and "guaranteed" because the investments in the bonds were backed by the "full faith and credit" of the United States Government and the investments were structured in a way that permitted withdrawal of principal and interest much earlier than traditional annuities. Relying on the promises of a purportedly safe and more profitable alternative to annuities, individuals from across the country invested approximately $4.3 million in the scheme.

9. These representations were false. Snisky did not purchase any agency bonds, nor did he engage in any overnight banking sweeps. Rather, he misappropriated approximately $2.8 million of investor funds, mostly through cash withdrawals. He then used these funds to pay commissions to his sales staff, as well as make personal expenditures (such as mortgage payments).

10. The salespeople were actively involved in the recommendation and advising process concerning the Arete and Snisky PIV investments by investors, and participated in the order taking process to initiate the purchases. In exchange for soliciting the investors, the salespeople were promised transaction-based compensation, which amounted to a percentage of the funds invested with Snisky through his companies.

11. In 2011, Tomich was introduced to Snisky and his programs by another salesperson who received a 1.5% commission on the total amount of funds brought in by the Respondent.

12. Tomich operated his business Strategic Planning Services, where he marketed his investment strategies as one to "protect [your] financial assets and maintain [your] standard of living." Tomich also offered a seminar called ABC Conservative Investing concerning life insurance and fixed annuities at a local college, where he gained some of his clients. Tomich traveled to Colorado in early 2012 to meet Snisky and learn about the Arete investments. From April 2012 to October 2012, Tomich solicited current and prospective insurance clients and advised clients on the merits of the investment. He sold investments in Arete to seven investors, all Michigan residents, securing approximately $969,848 for Snisky, which funds were transferred

to bank accounts in Colorado. Tomich received a 5% commission on the invested funds and received $48,327 in total commissions through the Cromarty Group on these sales.

13. In the course of his solicitation, Tomich: (1) directly and regularly solicited current and prospective insurance clients for investments in Arete and the Snisky PIVs; (2) advised prospective investors on the specific details and merits of the investments; (3) received transaction-based compensation for bringing in money from investors; (4) participated at key points in the investment chain; and (5) sold multiple issuers to multiple investors.

14. At no point between August 2011 and October 2012 was Tomich registered with the Commission as a broker, nor was he associated with a registered broker-dealer at the time of these activities.

VIOLATIONS

15. Section 15(a) of the Exchange Act, among other things, prohibits a broker or a natural person not associated with a broker (other than such a broker whose business is exclusively intrastate and who does not make use of any facility of a national securities exchange) to make use of the mails or any means or instrumentality of interstate commerce to effect any transactions in, or to induce or attempt to induce the purchase or sale of, any security (other than an exempted security or commercial paper, bankers' acceptances, or commercial bills) unless such broker is registered in accordance with Section 15(b). Scienter is not an element of a violation of Section 15(a). SEC v. Rabinovich & Assocs., LP, 2008 U.S. Dist. LEXIS 93595, at *14 (S.D.N.Y. 2008).

16. As a result of the conduct described above, Tomich willfully violated Section 15(a) of the Exchange Act.

IV.

In view of the foregoing, the Commission deems it appropriate, in the public interest, and for the protection of investors to impose the sanctions agreed to in Respondent Tomich's Offer.

Accordingly, pursuant to Sections 15(b) and 21C of the Exchange Act and Section 9(b) of the Investment Company Act, it is hereby ORDERED that:

A. Respondent Tomich cease and desist from committing or causing any violations and any future violations of Section 15(a) of the Exchange Act.

B. Respondent Tomich be, and hereby is:

barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization;

prohibited from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter; and

barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

C. Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

D. Respondent shall pay disgorgement of $48,327.00, which represents profits gained as a result of the conduct described herein, prejudgment interest of $2,976.87, and civil penalties of $48,000.00 to the Securities and Exchange Commission. Payment shall be made in the following installments:

Within fourteen days of entry of the Order, Respondent shall pay $55,303.87.

On January 15, 2015, Respondent shall pay $4,000.00.

On February 15, 2015, Respondent shall pay $4,000.00.

On March 15, 2015, Respondent shall pay $4,000.00.

On April 15, 2015, Respondent shall pay $4,000.00.

On May 15, 2015, Respondent shall pay $4,000.00.

On June 15, 2015, Respondent shall pay $4,000.00.

On July 15, 2015, Respondent shall pay $4,000.00.

On August 15, 2015, Respondent shall pay $4,000.00.

On September 15, 2015, Respondent shall pay $4,000.00.

On October 15, 2015, Respondent shall pay $4,000.00.

On November 15, 2015, Respondent shall pay $4,000.00.

If any payment is not made by the date when the payment is required by this Order, the entire outstanding balance of disgorgement, prejudgment interest, and civil penalties, plus any additional interest accrued pursuant to SEC Rule of Practice 600 or pursuant to 31 U.S.C. § 3717, shall be due and payable immediately, without further application. Payment must be made in one of the following ways:

(1) Respondent may transmit payment electronically to the Commission, which will provide detailed ACH transfer/Fedwire instructions upon request;

(2) Respondent may make direct payment from a bank account via Pay.gov through the SEC website at http://www.sec.gov/about/offices/ofm.htm; or

(3) Respondent may pay by certified check, bank cashier's check, or United States postal money order, made payable to the Securities and Exchange Commission and hand-delivered or mailed to:

Enterprise Services Center
Accounts Receivable Branch
HQ Bldg., Room 181, AMZ-341
6500 South MacArthur Boulevard
Oklahoma City, OK 73169

Payments by check or money order must be accompanied by a cover letter identifying Mark S. "Mike" Tomich as a Respondent in these proceedings, and the file number of these proceedings; a copy of the cover letter and check or money order must be sent to Thomas J. Krysa, Associate Regional Director, Securities and Exchange Commission, 1961 Stout St., Suite 1700, Denver, CO 80294-1961.

E. The Commission will hold funds paid in this proceeding pending a decision whether the Commission, in its discretion, will seek to distribute funds or transfer them to the U.S. Treasury. The Commission may distribute civil money penalties collected in this proceeding if, in its discretion, the Commission orders the establishment of a Fair Fund pursuant to 15 U.S.C. § 7246, Section 308(a) of the Sarbanes-Oxley Act of 2002, as amended. Regardless of whether a Fair Fund is created, amounts ordered to be paid as civil money penalties pursuant to this Order shall be treated as penalties paid to the government for all purposes, including all tax purposes. To preserve the deterrent effect of the civil penalty, Respondent agrees that in any Related Investor Action, he shall not argue that he is entitled to, nor shall he benefit by, offset or reduction of any award of compensatory damages by the amount of any part of Respondent's payment of a civil penalty in this action ("Penalty Offset"). If the court in any Related Investor Action grants such a Penalty Offset, Respondent agrees that he shall, within 30 days after entry of a final order granting the Penalty Offset, notify the Commission's counsel in this action and pay the amount of the Penalty Offset to the Securities and Exchange Commission. Such a payment shall not be deemed an additional civil penalty and shall not be deemed to change the amount of the civil penalty imposed in this proceeding. For purposes of this paragraph, a "Related Investor Action" means a private damages action brought against Respondent by or on behalf of one or more investors based on substantially the same facts as alleged in the Order instituted by the Commission in this proceeding.

V.

It is further Ordered that, solely for purposes of exceptions to discharge set forth in Section 523 of the Bankruptcy Code, 11 U.S.C. § 523, the findings in this Order are true and admitted by Respondent, and further, any debt for disgorgement, prejudgment interest, civil penalty or other amounts due by Respondent under this Order or any other judgment, order, consent order, decree or settlement agreement entered in connection with this proceeding, is a debt for the violation by Respondent of the federal securities laws or any regulation or order issued under such laws, as set forth in Section 523(a)(19) of the Bankruptcy Code, 11 U.S.C. § 523(a)(19).

By the Commission.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Release No. 73926 / December 23, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16327

In the Matter of FOTIOS GEIVELIS, JR., Respondent.	ORDER INSTITUTING PUBLIC ADMINISTRATIVE PROCEEDINGS PURSUANT TO SECTION 15(b) OF THE SECURITIES EXCHANGE ACT OF 1934, MAKING FINDINGS, AND IMPOSING REMEDIAL SANCTIONS

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative proceedings be, and hereby are, instituted pursuant to Section 15(b) of the Securities Exchange Act of 1934 ("Exchange Act") against Fotios Geivelis, Jr. also known as Frank Anastasio ("Geivelis" or "Respondent").

II.

In anticipation of the institution of these proceedings, Respondent has submitted an Offer of Settlement (the "Offer") which the Commission has determined to accept. Solely for the purpose of these proceedings and any other proceedings brought by or on behalf of the Commission, or to which the Commission is a party, and without admitting or denying the findings herein, except as to the Commission's jurisdiction over him and the subject matter of these proceedings and the findings contained in Section III.2 and III.4 below, which are admitted, Respondent consents to the entry of this Order Instituting Public Administrative Proceedings Pursuant to Section 15(b) of the Securities Exchange Act of 1934, Making Findings, and Imposing Remedial Sanctions ("Order"), as set forth below.

III.

On the basis of this Order and Respondent's Offer, the Commission finds that:

1. Geivelis, also known as Frank Anastasio, age 33, was the sole managing member and owner of Worldwide Funding III Limited, LLC ("Worldwide Funding"), a Florida limited liability company. During 2012 and 2013, Geivelis resided in Wyckoff, New Jersey and Tampa, Florida. Geivelis was not registered as, or associated with, a broker or dealer that was registered with the Commission.

2. On August 29, 2013, the Commission filed a complaint against Geivelis and others in SEC v. Bernard H. Butts, Jr., et al. (S.D. Fla. Civil Action No. 1:13-cv-23115-JEM). On December 9, 2014, the court entered an order permanently enjoining Geivelis, by consent, from future violations of Sections 10(b) and 15(a) of the Exchange Act and Rule 10b-5 thereunder, and Sections 5 and 17(a) of the Securities Act of 1933 ("Securities Act"). Geivelis was also ordered jointly and severally to pay $2,149,680.00 in disgorgement of ill-gotten gains from his conduct alleged in the complaint, and $126,708.08 in prejudgment interest; and a $2,149,680.00 civil money penalty.

3. The Commission's complaint alleged, among other things, that from April 2012 through August 2013, Geivelis obtained millions of dollars by defrauding investors through the offer and sale of investments in a fictitious prime bank instrument trading program. The complaint also alleged Geivelis told investors that a $60,000 to $90,000 investment would generate profits of at least €6,660,000 (Euros) within 15 to 45 business days and earn profits of approximately 14% per week for 40 to 42 weeks. In addition, the complaint alleged that Geivelis falsely promised that investors' funds were deposited into an attorney's trust account, and would not be released until proof was received that a €10,000,000 Standby Letter of Credit ("SBLC") had been deposited into a securities trading program. Further, the complaint alleged Geivelis did not disclose that instead of using the funds to obtain SBLCs, he misappropriated investors' funds with the attorney and him each taking approximately 45% of the investors' funds and paying approximately 10% to sales agents who located the investors. The complaint also alleged that contrary to the defendants' representations, the acquisition of the SBLCs never occurred, no loans were obtained, and no returns were earned in a trading program or paid to investors. Furthermore, the complaint alleged that over more than a year, the defendants obtained at least $3.5 million from approximately forty-five investors nationwide and in foreign countries by making false and misleading statements or omitting material facts in the offer and sale of these unregistered securities.

4. On March 18, 2014, Geivelis pleaded guilty to one count of wire fraud in violation of Title 18 United States Code, Section 1343 before the United States District Court for the Western District of Pennsylvania, in United States v. Fotios Geivelis, Jr., Crim. No. 2:13-cr-307-NBF-1.

5. The criminal indictment to which Geivelis pled guilty alleged, among other things, that:

a. Geivelis operated Worldwide Funding III Limited ("WWF"), a Florida limited liability company which solicited Internet applications for multi-million dollar loans.
b. From April 2012, through September 2013, Geivelis knowingly and intentionally devised a scheme and artifice to defraud and for obtaining money and property by investors by means of false and fraudulent pretenses, representations and promises.
c. Geivelis made false representations to investors including that a $60,000 to $90,000 payment would enable an investor to obtain a $10,000,000 loan; the loan would be funded within 15 banking days; and would be repaid through private placement trading facilitated by Geivelis; that the investor's money would be held in a Paymaster's escrow account until confirmation of a multi-million dollar SBLC at the foreign bank; and that the investor's money would be returned if WWF did not perform on the contract.
d. Geivelis executed the scheme and artifice by obtaining approximately $3.9 million in wire transfers to the Paymaster's escrow accounts from more than 3 dozen investors seeking multi-million dollar overseas loans; providing false documentations to investors in order to reassure them that the WWF program was legitimate, assuring investors that their money would be held by the Paymaster in escrow, pending SBLC confirmation by foreign banks; failing to hold investors' money in escrow and instead distributing it to the Paymaster, to brokers who introduced investors to WWF, and to himself for his own use; dissipating investors' money on personal expenses, including hotels, casinos, restaurants, strip clubs, automobiles, clothing and jewelry; and failing to obtain any loans for investors and making few refunds of investors' funds.
e. On or about August 24, 2012, Geivelis executed the scheme and artifice to defraud by causing to be transmitted in interstate commerce by means of wire communications, certain writings, signs and signals in the form of a bank wire transfer of $120,000 from M.D. First National Bank of Pennsylvania in Pittsburg, Pennsylvania to B.B. JPMC account in Miami, Florida in violation of Title 18, United States Code, Section 1343.

IV.

In view of the foregoing, the Commission deems it appropriate and in the public interest to impose the sanctions agreed to in Respondent Geivelis' Offer.

Accordingly, it is hereby ORDERED, pursuant to Section 15(b)(6) of the Exchange Act that Geivelis be, and hereby is barred from association with any broker, dealer, investment adviser, municipal securities dealer, municipal advisor, transfer agent, or nationally recognized statistical rating organization; and barred from participating in any offering of a penny stock, including: acting as a promoter, finder, consultant, agent or other person who engages in activities with a broker, dealer or issuer for purposes of the issuance or trading in any penny stock, or inducing or attempting to induce the purchase or sale of any penny stock.

Any reapplication for association by the Respondent will be subject to the applicable laws and regulations governing the reentry process, and reentry may be conditioned upon a number of factors, including, but not limited to, the satisfaction of any or all of the following: (a) any disgorgement ordered against the Respondent, whether or not the Commission has fully or partially waived payment of such disgorgement; (b) any arbitration award related to the conduct that served as the basis for the Commission order; (c) any self-regulatory organization arbitration award to a customer, whether or not related to the conduct that served as the basis for the Commission order; and (d) any restitution order by a self-regulatory organization, whether or not related to the conduct that served as the basis for the Commission order.

By the Commission.

Brent J. Fields
Secretary

Kevin M. O'Neill

By: Kevin M. O'Neill
Deputy Secretary

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

SECURITIES EXCHANGE ACT OF 1934
Rel. No. 73949 / December 29, 2014

Admin. Proc. File No. 3-16268

In the Matter of ROBERT C. WEAVER, JR., ESQ.	ORDER DENYING MOTION TO LIFT TEMPORARY SUSPENSION AND DIRECTING HEARING

On November 12, 2014, we issued an order ("Temporary Suspension Order"), pursuant to Commission Rule of Practice 102(e)(3)(i)(A),[1] temporarily suspending Robert C. Weaver, Jr., Esq., an attorney licensed to practice law in California, from appearing or practicing before the Commission as an attorney.[2] Weaver has filed a timely petition, pursuant to Rule 102(e)(3)(ii),[3] requesting that his temporary suspension be lifted. For the reasons set forth below, we have determined to deny Weaver's petition and to set the matter down for a hearing before an administrative law judge.

On August 13, 2012, the Commission filed a civil action against Weaver (and others) in federal district court, alleging that, between 2006 and 2011, Weaver participated in a scheme to create, register, and sell fifteen public shell companies putatively engaged in mining operations.[4] The complaint alleged that, as part of the scheme, Weaver wrote opinion letters for registration

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1 17 C.F.R. § 201.102(e)(3)(i)(A) (providing, in part, that "[t]he Commission, with due regard to the public interest and without preliminary hearing, may, by order, temporarily suspend from appearing or practicing before it any attorney . . . who has been by name: (A) permanently enjoined by any court of competent jurisdiction, by reason of his or her misconduct in an action brought by the Commission, from violating or aiding and abetting the violation of any provision of the Federal securities laws or of the rules and regulations thereunder").

2 *Robert C. Weaver, Jr., Esq.*, Securities Exchange Act Release No. 73578, 2014 WL 5842376 (Nov. 12, 2014).

3 17 C.F.R. § 201.102(e)(3)(ii).

4 *See SEC v. Thomas D. Coldicutt, Jr., et al.*, Civil Action No. 4:12-CV-00505 (E.D. Tex. Aug. 13, 2012). The case subsequently was transferred from the U.S. District Court for the Eastern District of Texas to the U.S. District Court for the Central District of California.

statements filed on behalf of the shell companies, acted as counsel for three of the companies, and served as the sole officer and director for one of the companies, Centaurus Resources Corp. The complaint also alleged that Weaver provided the initial funding for Centaurus, and that, in his capacity as Centaurus's officer and director, signed and certified filings with the Commission that contained false and inaccurate statements.

On August 15, 2014, the district court entered a final judgment by consent against Weaver,[5] permanently enjoining him from future violations of Sections 17(a)(2) and 17(a)(3) of the Securities Act of 1933, Section 15(d) of the Securities Exchange Act of 1934, and Exchange Act Rules 12b-20, 15d-1, 15d-13, and 15d-14.[6] The final judgment also prohibited Weaver from acting as an officer or director of a public company for five years; barred him from participating in penny stock offerings for five years; and required him to pay $55,175.07 in disgorgement, plus $9,218.27 in prejudgment interest, and a $50,000 civil penalty.

In issuing the Temporary Suspension Order, we found it "appropriate and in the public interest" that Weaver be temporarily suspended from appearing or practicing before the Commission based on the district court's final judgment.[7] We stated that the temporary suspension would become permanent unless Weaver filed a petition seeking to lift it within thirty days of service of the Temporary Suspension Order pursuant to Rule 102(e)(3)(ii).[8] We further advised that, pursuant to Rule 102(e)(3)(iii), upon receipt of such petition, we would either lift the temporary suspension, set the matter down for a hearing, or both.[9]

In his petition, Weaver argues that "a temporary suspension that automatically becomes a permanent indefinite suspension is unjust and unwarranted." He requests that we "reconsider this order [the Temporary Suspension Order] and/or set this matter down for a hearing." The Office of the General Counsel ("OGC") has opposed lifting the temporary suspension and requests that we set the matter down for a hearing.

After considering the parties' arguments and the applicable law, we have determined to deny Weaver's petition and to set the matter down for a hearing.[10] In the Temporary Suspension

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5 *SEC v. Thomas D. Coldicutt, Jr., et al.*, Civil Action No. 2:13-CV-01865-RGK-VBK (C.D. Ca. Aug. 15, 2014).

6 15 U.S.C. §§ 77q(a) & 78o(d); 17 C.F.R. §§ 240.12b-20, .15d-1, .15d-13, and .15d-14.

7 *Weaver*, 2014 WL 5842376, at *2.

8 *Id.*

9 *Id.*

10 The Commission has denied similar petitions in the recent past. *See, e.g.*, *Brian Williamson, Esq.*, Exchange Act Release No. 72435, 2014 WL 2769502 (June 19, 2014); *Virginia K. Sourlis, Esq.*, Exchange Act Release No. 69358, 2013 WL 1453371 (Apr. 10, 2013); *Stewart A. Merkin, Esq.*, Exchange Act Release No. 68981, 2013 WL 661621 (Feb. 25, 2013); *Jilaine H. Bauer, Esq.*, 2012 WL 5493356; *Mitchell Segal, Esq.*, Exchange Act Release No. 67930, 2012 WL

(continued...)

Order, the Commission deemed it "appropriate and in the public interest" that Weaver be temporarily suspended, and Weaver has not offered any persuasive reason to question that determination. Continuing Weaver's temporary suspension pending a hearing on the issues raised in his petition serves the public interest and protects the Commission's processes. As discussed, a court of competent jurisdiction has permanently enjoined Weaver, an attorney, from violating the federal securities laws. The findings made in the injunctive proceeding, which Weaver is precluded from contesting in this Rule 102(e)(3) proceeding, and the permanent injunction issued against him justify the continuation of his temporary suspension until it can be determined what, if any, action may be appropriate to protect the Commission's processes.[11]

Under the circumstances, we find it appropriate to deny Weaver's request to lift the temporary suspension and continue his suspension pending the holding of a public hearing and a decision by a law judge. As provided in Rule 102(e)(3)(iii), we will set the matter down for a public hearing. We express no opinion as to the merits of Weaver's arguments.

Accordingly, IT IS ORDERED that this proceeding be set down for a public hearing before an administrative law judge in accordance with Commission Rule of Practice 110. As specified in Rule of Practice 102(e)(3)(iii), the hearing in this matter shall be expedited in accordance with Rule of Practice 500; it is further

ORDERED that the administrative law judge shall file an initial decision no later than 210 days from the date of service of this order; and it is further

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(...continued)
4458283 (Sept. 26, 2012); *Ran H. Furman*, Exchange Act Release No. 65680, 2011 WL 5231425 (Nov. 3, 2011); *Michael C. Pattison, CPA*, Exchange Act Release No. 64598, 2011 WL 2169094 (June 3, 2011); *Carl W. Jasper, CPA*, Exchange Act Release No. 64077, 2011 WL 881508 (Mar. 11, 2011); *William D. Shovers*, Exchange Act Release No. 59874, 2009 WL 1271170 (May 6, 2009); *Chris G. Gunderson, Esq.*, Exchange Act Release No. 56396, 2007 WL 2668485 (Sept. 12, 2007); *Ulysses "Thomas" Ware*, Exchange Act Release No. 51222, 2005 WL 399675 (Feb. 17, 2005); *Daniel S. Lezak*, Exchange Act Release No. 50729, 2004 WL 2721400 (Nov. 23, 2004); *Herbert M. Campbell, II*, Exchange Act Release No. 43422, 2000 WL 1482918 (Oct. 6, 2000).

[11] *See* 17 C.F.R. § 201.102(e)(3)(iv) (stating that, in any hearing held on a petition filed in accordance with Rule 102(e)(3)(ii), the petitioner may not contest any findings made against him in the underlying proceeding).

ORDERED that Robert C. Weaver, Jr., Esq.'s petition to lift the temporary suspension is denied, and that the temporary suspension shall remain in effect pending a hearing and decision in this matter.

By the Commission.

Brent J. Fields
Secretary

Commissioner Piwowar
Not Participating

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

INVESTMENT ADVISERS ACT OF 1940
Release No. 3991 / December 29, 2014

INVESTMENT COMPANY ACT OF 1940
Release No. 31402 / December 29, 2014

ADMINISTRATIVE PROCEEDING
File No. 3-16328

In the Matter of **VERO CAPITAL MANAGEMENT, LLC, ROBERT GEIGER, GEORGE BARBARESI, and STEVEN DOWNEY, CPA** **Respondents.**	**ORDER INSTITUTING ADMINISTRATIVE AND CEASE-AND-DESIST PROCEEDINGS PURSUANT TO SECTIONS 203(e), 203(f), AND 203(k) OF THE INVESTMENT ADVISERS ACT OF 1940, SECTION 9(b) OF THE INVESTMENT COMPANY ACT OF 1940, AND RULE 102(e)(1) OF THE COMMISSION'S RULES OF PRACTICE**

I.

The Securities and Exchange Commission ("Commission") deems it appropriate and in the public interest that public administrative and cease-and-desist proceedings be, and hereby are, instituted pursuant to Sections 203(e), 203(f), and 203(k) of the Investment Advisers Act of 1940 ("Advisers Act") and Section 9(b) of the Investment Company Act of 1940 ("Investment Company Act") against VERO Capital Management, LLC ("VERO Capital"), Robert Geiger ("Geiger), George Barbaresi ("Barbaresi"), and Steven Downey ("Downey") (collectively "Respondents") and pursuant to Rule 102(e)(1) of the Commission's Rules of Practice against Downey.

II.

After an investigation, the Division of Enforcement ("Division") alleges that:

A. SUMMARY

1. These proceedings arise out of Respondents' fraud on VERO Capital's advisory clients, the VERO Distressed ABS Opportunity Fund, B.V. ("Distressed Fund") and the VERO Distressed ABS Opportunity Master Fund, B.V. (the "Master Fund" and, collectively with the Distressed Fund, the "Funds").

2. Between late 2010 and 2011, Respondents caused the Funds to purchase three notes, worth a total of $7 million, from VERO Asset Management, LLC ("VERO Asset"), an affiliate of Vero Capital. Because the Funds were purchasing the notes from a Vero Capital affiliate, the transactions constituted principal transactions under Section 206(3) of the Advisers Act, which require written notice and consent of the client before the completion of the transaction. Respondents, however, made no efforts to provide the required notice to the Funds or obtain the required consents for the three transactions.

3. Thereafter, from 2012 to 2013, Respondents wrongfully diverted $4.4 million dollars from the Funds to VERO Capital's wholly-owned subsidiary, Gresham Risk Partners LLC ("Gresham"), by causing the Funds to make a series of undocumented, undisclosed bridge loans to Gresham. At the same time Respondents were funneling the Funds' assets to Gresham, they were telling the Distressed Fund's investors and the Funds' director that they were winding down the Funds and actively working to liquidate their remaining investments for redemption. None of the Respondents disclosed the bridge loans to the Funds or any of their investors. Instead, each of the Respondents actively sought to conceal the loans.

B. RESPONDENTS

4. **VERO Capital** is a Delaware limited liability company formed in 2003 with its principal place of business in New York, New York. It has been registered with the Commission as an investment adviser since 2008. VERO Capital is the investment manager to the Distressed Fund. VERO Capital is owned by a collection of individuals, including Respondents Geiger, Downey, and Barbaresi.[1] VERO Capital has several wholly-owned subsidiaries including Gresham.

5. **Geiger**, age 55, resides in Wainscott, New York. Geiger is a co-owner of VERO Capital, and through it, Gresham, and has served as VERO Capital's managing member since 2003. Since 2010, Geiger has served on VERO Capital's Investment Committee. Geiger is Gresham's president as well. Geiger is not currently registered with the Commission but has held Series 3, 7, and 63 licenses.

4. **Barbaresi**, age 60, resides in White Plains, New York. Barbaresi is a co-owner of VERO Capital, and through it, Gresham, and has served as VERO Capital's general counsel since December 2003. Since 2010, Barbaresi has served on VERO

[1] Geiger owns 42.30%, Barbaresi owns 11.53%, and Downey owns 5.39% of VERO Capital's equity.

Capital's Investment Committee. Barbaresi is Gresham's general counsel as well. Barbaresi is an attorney in good standing licensed to practice in New York, Connecticut, and the District of Columbia

5. **Downey**, age 57, resides in Prospect, Kentucky. Downey is a co-owner of VERO Capital, and through it, Gresham, and has served as VERO Capital's chief financial officer since August 2004. Since 2010, Downey has served on VERO Capital's Investment Committee. Downey is Gresham's chief financial officer as well. Downey has been a certified public accountant licensed to practice in Florida and Alabama, although his license is not currently active in any jurisdiction.

C. <u>OTHER RELEVANT ENTITIES</u>

6. **Gresham** is a Delaware limited liability company formed in 2008 with its principal place of business in New York, New York. It is a wholly-owned subsidiary of VERO Capital. Gresham's officers and its marketing materials describe the company as a risk analytics business.

7. The **Distressed Fund** is a private company with limited liability incorporated under the laws of the Netherlands in 2008. The Distressed Fund is 100% owned by Stichting VERO Distressed ABS Opportunity Fund, a foundation established under the laws of the Netherlands, and incorporated by TMF Management, B.V. ("TMF Management"), a Dutch corporate services provider. The Distressed Fund aimed to achieve returns by investing in the affiliated Master Fund, which made investments in various securities.

8. The **Master Fund** is a private company with limited liability incorporated under the laws of the Netherlands in 2007. The Master Fund is 100% owned by Stichting VERO Distressed ABS Opportunity Master Fund, a foundation established under the laws of the Netherlands, and incorporated by TMF Management. The Master Fund's stated investment objective was to maximize returns by investing in a diverse portfolio of mortgage-related structured finance securities, whole mortgage loans and other fixed-income instruments.

9. **VERO Asset** is a Delaware limited liability company formed in 2003 with its principal place of business in New York, New York. VERO Asset is a wholly-owned subsidiary of VERO Capital that made certain loans, including one to Cayden Holdings, LLC ("Cayden"), a VERO Capital affiliate, that the Funds later purchased.

10. **VERO Realty Advisors, LLC ("VERO Realty")** is a Delaware limited liability company formed in 2012 with its principal place of business in New York, New York. VERO Realty is a wholly-owned subsidiary of VERO Capital. Certain funds that VERO Capital diverted from the Funds to Gresham in 2013 were initially transferred to a bank account held in the name of VERO Realty.

11. **Cayden** is a Delaware limited liability company formed in 2007 with its principal place of business in Baltimore, Maryland. Cayden is a wholly-owned subsidiary

of VERO Asset. The Funds purchased a note from VERO Asset in November 2010 that evidenced a $3 million loan that VERO Asset had made to Cayden (the "Cayden Note"). VERO Capital ultimately diverted to Gresham money that was due to the Funds to repay the $3 million loan.

12. **TMF Management** is a Dutch private company with limited liability headquartered in Amsterdam, The Netherlands. TMF Management served as director for the Distressed Fund and the Master Fund and provided management, corporate and administrative services to the Funds, with the exception of investment management services, which VERO Capital provided.

D. FACTS

Background

13. The Distressed Fund and the Master Fund are structured in a master-feeder relationship. The Distressed Fund is the feeder fund and aimed to generate returns by investing substantially all of its cash (raised from issuing notes to investors) in notes issued by the Master Fund. The Master Fund would then use those proceeds to invest in mortgage-related finance securities and other distressed investments, as described below. Both the Distressed and Master Funds are Dutch companies each of whose shares are entirely owned by separate Dutch foundations, or "stichtings." The stichtings were incorporated by TMF Management, a Dutch corporate services provider, which serves as the director for both Funds. The stichtings are legal entities without shareholders whose object is to hold the shares of the Funds and have overall control over the Funds' management. However, the Funds, through TMF Management, delegated to Vero Capital the exclusive power and authority to manage the Funds' investments on a discretionary basis.

14. VERO Capital marketed the Distressed Fund to three foreign investors in 2008, raising approximately $80 million by selling them participating notes issued by the Fund, with the vast majority coming from two of the three investors. According to the Distressed Fund's private placement memorandum ("PPM"), its principal investment objective was to achieve returns by investing through the Master Fund in a diverse portfolio of mortgage-related finance securities, whole mortgage loans and other fixed income instruments, including rated or unrated and performing or distressed securities issued by issuers of collateralized debt obligations, and special situation investments. The Distressed Fund could invest in a broad array of assets, but the Distressed Fund's PPM stated that "[i]t is intended that the portfolio will consist of approximately 80% U.S. RMBS Securities and there will be no . . . corporate credit risk." The Distressed Fund's two biggest investors understood that the Fund's primary purpose was to invest in mortgage-backed securities.

15. With respect to transactions involving affiliates of VERO Capital, the PPM stated that VERO Capital may purchase loans originated or syndicated by any affiliate of VERO Capital or otherwise engage in affiliated transactions on behalf of the Fund. However, to do so, VERO Capital was required to obtain the prior written consent of a

committee comprised of VERO Capital's investment professionals (the "Investment Committee"). At all times relevant to this action, Geiger, Barbaresi, and Downey were members of the Investment Committee. No person independent of VERO Capital served on the Investment Committee.

Purchase of the Cayden Note

16. After their inception, the Funds invested primarily in residential and then commercial mortgage-backed securities ("RMBS" and "CMBS"). They undertook other investments as well. Specifically, in November 2010, the Investment Committee, on which Geiger, Downey, and Barbaresi sat, approved a transaction in which the Distressed Fund was to purchase the $3 million Cayden Note from VERO Asset.[2] Under the terms of the Cayden Note, VERO Asset loaned $3 million to another VERO Capital affiliate, Cayden. The Cayden Note paid 15% interest per annum due in monthly installments, with the entire principal due on December 1, 2013. The interest rate increased to 19% per annum in the event of a default. The Cayden Note also provided that its holder could accelerate the payment of the Note's principal in the event of a default.

17. Although this affiliated investment was documented by a written authorization by the Investment Committee, no one at VERO Capital prepared any other documentation concerning the transaction. The investment was not disclosed prior to its completion to TMF Management or to any Distressed Fund investor; nor was consent for the investment obtained from any party outside VERO Capital.

18. The consent authorizing the purchase of the Cayden Note made clear that the purpose for the loan was for Cayden to make certain trades involving Government National Mortgage Association ("GNMA") mortgage-backed securities. Cayden's business plan was to enter into agreements to fund Federal Housing Administration backed fixed-rate construction loan commitments. Draws funded under the loan commitments were guaranteed as to the principal by GNMA, and therefore once the loans were made, they were securitized and Cayden sold the GNMA securities into the aftermarket (the "GNMA trading strategy"). The GNMA trading strategy generated profits for Cayden through 2011 and 2012.

19. VERO Capital disclosed the Master Fund's purchase of the Cayden Note and Cayden's GNMA trading strategy in the notes to the Master Fund's year-end 2010 audited financial statements, which were sent to the Distressed Fund's investors in April 2011. Cayden made interest payments on the Cayden Note to the Master Fund until February 2013 at which point Cayden defaulted. Although Cayden's failure to pay interest

[2] In fact, the Master Fund purchased the Cayden Note according to the 2010 audited financial statements. The PPM disclosed that the Distressed Fund and the Master Fund would be treated interchangeably: "Unless specified otherwise, references herein to the Fund's investments and investment program include references to the Master Fund's investments and investment program, to the extent that the Fund invests through the Master Fund." Geiger, Downey and Barbaresi made little effort to distinguish among them.

when due permitted the Master Fund to accelerate the maturity of the Cayden Note, VERO Capital made no effort to collect on the Cayden Note on the Funds' behalf, as described below.

Purchase of the Envo and Tallas Notes

20. In December 2011, the Investment Committee approved the Distressed Fund's purchase of two additional promissory notes from VERO Asset.[3] Under the terms of the notes, VERO Asset loaned $2 million each to two unaffiliated issuers, Envo Properties, LLC ("Envo") and Tallas Properties, LLC ("Tallas"). The loans' purpose was for Envo and Tallas to make real-estate related investments. The notes (hereinafter the "Envo and Tallas Notes") paid 12% interest per annum. The Envo and Tallas Notes were guaranteed by an individual and were due to mature January 31, 2013.

21. On December 12, 2011, approximately one week after VERO Asset originated the Envo and Tallas Notes and the Master Fund purchased them, the Commission charged the guarantor and others with operating a Ponzi scheme. *See SEC v. Management Solutions, Inc.*, No. 2:11-cv-01165-BSJ (D. Utah). Simultaneously with the filing of its lawsuit, the Commission obtained a court order freezing the guarantor's assets and the assets of entities under his control, including Envo and Tallas. Like the purchase of the Cayden Note, the Investment Committee approved the purchase of the Envo and Tallas Notes, but no one at Vero Capital prepared any other formal documentation concerning the transaction. The investments were not disclosed prior to their being completed to TMF Management or to any Distressed Fund investor; nor was consent for the investments obtained from any party outside Vero Capital.

22. In early 2012, Barbaresi and Downey took steps to recoup the principal on the Envo and Tallas Notes. As a result of those efforts, in July 2012, VERO Capital recouped approximately $2.1 million of the principal on the Envo and Tallas Notes. Of this amount, VERO Capital returned $1.5 million to the Master Fund in September 2012. As described further below, VERO Capital diverted the remaining approximately $600,000 to Gresham.

23. VERO Capital disclosed the purchase of the Envo and Tallas Notes in the notes to the Funds' audited financial statements for year-end 2011. In addition, in April 2012, VERO Capital sent a letter to the Distressed Fund's investors, enclosing the audited 2011 financial statements for the Funds, that described the situation with the Envo and Tallas Notes. In the letter, VERO Capital stated that it was placing the Envo and Tallas loans on "non-accrual status" and "after much deliberation" was adjusting the fair value of the notes to approximately $1.8 million for each note to "reflect a liquidity discount."

[3] As was true with the purchase of the Cayden Note, the 2011 audited financial statements indicate that it was the Master Fund, not the Distressed Fund, that purchased the Envo and Tallas Notes.

Respondents Communicate that the Funds Are Winding Down and Investors Will Be Redeemed

24. By the fall of 2011, VERO Capital began returning principal to the Distressed Fund's investors. In a June 2012 email, a representative of one of the investors sought information from Geiger about the timing of the wind down and return of investment: "My understanding was the [sic] VERO should have been redeemed in full by now. As it's not, do you have a liquidity schedule for the remaining part?" Geiger responded that VERO Capital had been returning principal "since last Fall" and that VERO Capital was "seeking to make three more distributions before the end of the year, returning the remainder by year end, with a potential tail in January" 2013. After the same investor representative asked for an update at the beginning of September 2012, Downey drafted an email response ultimately sent by Barbaresi stating that VERO Capital remained committed to making another distribution in October 2012. Barbaresi added: "As we continue to sell assets and raise cash, we will be able to obtain greater clarity around the liquidity in the market. We should know by early December if the third distribution will be in December or later as we continue to gain clarity and finish the wind up of the fund."

25. In 2013, the Distressed Fund's two major investors continued to ask about the status of the Fund's wind-down and the return of their principal. For example, in April 2013, a representative of one of these investors asked for another update on the Distressed Fund's wind-down, noting that "[b]ack in Jun/12 the fund was estimated to be fully distributed before end of 2012, with a potential tail into Jan/13." Barbaresi responded later in the month: "We have been actively liquidating the fund's assets and the remaining assets are very illiquid. . . . We hope to have the remaining assets sold by the second half of the year and will keep you updated on ongoing asset sales and distributions." Subsequently, in May, Barbaresi told another investor representative that "[w]e really can't accurately predict when the final liquidation of the fund will occur, as we discussed, we are looking at options to put the last of the illiquid assets into a structure that will not incur administrative fees."

26. In June 2013, Downey, in response to questions by TMF Management about when it could expect the Funds' 2012 audit reports, notified TMF Management that Vero Capital had begun to wind down the Fund, and that no audit had therefore been necessary for 2012. Prior to that time, none of the Respondents notified TMF Management of VERO Capital's intentions to liquidate the Funds, and the only notice TMF Management received of the Funds' return of principal to investors was a line item in the 2011 audited financial statements that TMF Management received some time in or after April 2012.

The Undisclosed Loans from the Funds to Finance Gresham

27. Beginning in at least 2008, while it was serving as investment manager to the Funds, VERO Capital was also developing a risk management business or financial services technology company called Gresham. Gresham's business plan was to provide large financial institutions with a platform to assist them with modeling the valuation of various pieces of their portfolios in different economic scenarios. VERO Capital anticipated that the demand for this type of service would increase following the financial

crisis in 2008 and the passage of the Dodd-Frank Act, with its requirements that large financial institutions perform "stress tests" on their portfolios.

28. Gresham has been and continues to be a wholly-owned affiliate of VERO Capital. Because they are co-owners of VERO Capital, Geiger, Barbaresi, and Downey are also co-owners of Gresham. In approximately 2010, Downey began treating Gresham as a separate entity for accounting purposes, booking revenues and expenses of Gresham separately from VERO Capital. Beginning in 2010, most VERO Capital employees became employees of Gresham. By October 2013, Gresham had generated little more than $525,000 in total revenues since its inception in 2008.

29. Beginning in December 2012 and continuing through October 2013, when Commission examination staff commenced an examination of VERO Capital, Geiger, Barbaresi, and Downey, through VERO Capital, misappropriated $4.4 million in assets of the Funds for purposes of financing Gresham's operations. While informing the Distressed Fund's investors that the Funds were being wound down, Geiger, Barbaresi, and Downey at the same time diverted $4.4 million from the Funds through purported "bridge loans" to Gresham. These loans were never documented, nor were any of them disclosed to the Funds or their investors until well after the Division had commenced its investigation. In making the bridge loans to Gresham, Geiger, Barbaresi, and Downey did not follow the procedures for affiliated transactions set forth in the PPM. Nor were any of the bridge loans to Gresham reduced to writing; instead, Downey testified that he simply recorded the loans in the Master Fund's general ledger.

30. VERO Capital accomplished the transfers from the Funds to Gresham in multiple transactions. First, as the money invested through the Cayden Note in the GNMA trades was returned to Cayden as those trades were closed out throughout 2012, Geiger, Downey, and Barbaresi used that money, ultimately totaling $3 million, to benefit Gresham, rather than returning it to the Funds. Consequently, when the Cayden Note came due on December 1, 2013, Cayden had no money with which it could repay the principal due to the Funds. Downey arranged the transfer of the $3 million over time from accounts associated with Cayden to accounts associated with Vero Capital or Gresham, for Gresham's benefit. None of the Respondents prepared any documentation concerning the transfers to indicate whether they were loans or investments by Cayden in Gresham.

31. Second, in July 2012, VERO Capital secured the return of $2.1 million of the Envo and Tallas Notes' principal. While VERO Capital transferred $1.5 million of that amount back to the Funds, Geiger, Barbaresi, and Downey used the remaining $600,000 for the benefit of Gresham from December 2012 through February 2013. As VERO Capital and Gresham's CFO, Downey was primarily responsible for disbursing money on their behalf. Geiger and Barbaresi knew, or were reckless in not knowing, that Downey was using returned Envo and Tallas Note principal to benefit Gresham.

32. Finally, in August and September 2013, as Gresham's bank account was nearly depleted, and after VERO Capital had notified TMF Management that the Funds were being liquidated, Downey orchestrated two transfers, of $500,000 and $300,000, respectively, from the Master Fund's custodial bank account for the benefit of Gresham.

Downey directed the August and September 2013 transfers from the Master Fund's account at U.S. Bank to VERO Realty, another VERO Capital affiliate.

33. Because U.S. Bank also served as the Funds' administrator and therefore maintained their books and records, Downey had to provide a reason to U.S. Bank for the two disbursements so that U.S. Bank could document what the money was being used for.

34. In an August 1, 2013 email to U.S. Bank, Downey, copying Barbaresi, falsely advised the bank that VERO Capital (through its affiliate, VERO Realty) would invest the $500,000 that he requested in a property related to the Master Fund's Tallas Note in order to recoup additional principal on the Tallas Note. Downey and Barbaresi knew or were reckless in not knowing that the $500,000 would not be used to invest in a property related to the Tallas Note, but would instead be diverted to pay VERO Capital's and Gresham's expenses. Downey's email stated:

> "The loans that the [F]und made to Tallas were invested by Tallas in two properties in various entities. One of those properties is an apartment complex in Birmingham that we have been in discussions with the owner of to best determine how to get the [F]unds' loans paid back totaling $700,000 plus interest. The property was originally acquired as a rehab project, meaning all the units had to be renovated. While we had previously refused requests to fund this, we now have no choice to [sic] but to fund the buildout in order to recapture the existing loans. We will need to invest about $500,000 in the property and establish a blocker corporation between the [F]und and the ultimate apartment entity. This rehab will be overseen by [VERO Realty] (for no fee). [VERO Realty] will be making the investment on behalf of the blocker corporation for the benefit of the [F]und. . . . Please wire $500,000 to [VERO Realty] account in order to facilitate this transaction . . ."

35. The same day, U.S. Bank wired $500,000 to the VERO Realty account. Immediately thereafter, also on August 1, Downey transferred $80,000 of the $500,000 from the VERO Realty account to a VERO Capital account and used the money to pay for Gresham expenses. On August 2, Downey made two transfers of $50,000 and $20,000 from the VERO Realty account to the VERO Capital account, and then subsequently transferred that money to a Gresham account.

36. By September 12, 2013, Downey had transferred all of the $500,000 from the VERO Realty account for the benefit of Gresham. None of the $500,000 was used for the purposes Downey claimed in his August 1, 2013 email to U.S. Bank. Geiger knew, or was reckless in not knowing, that Downey and Barbaresi obtained the $500,000 from the Master Fund's account and used the money for Gresham.

37. Again, on September 26, 2013, Downey emailed U.S. Bank, this time copying Barbaresi and Geiger, requesting another transfer to VERO Realty for expenses related to the Tallas properties, again ostensibly for the purposes of recouping additional principal related to the Tallas Note. As part of his September 26, 2013 email, Downey forwarded the previous request for $500,000 that he made on August 1. Downey, Barbaresi, and Geiger knew, or were reckless in not knowing, that the September 26, 2013 transfer from the Master Fund account would not be used for expenses related to the Tallas properties.

38. U.S. Bank wired $300,000 to the VERO Realty account on September 26, and Downey began drawing down the account the next day. By October 23, 2013, Downey had used the entirety of the $300,000 for the benefit of Gresham; none went to any expenses related to the Tallas properties.

39. The $500,000 and $300,000 transferred from the Master Fund account on August 1, 2013 and September 26, 2013, respectively, were not approved or documented by the Fund's Investment Committee. Neither Downey, Barbaresi nor Geiger ever advised TMF Management, U.S. Bank, or Distressed Fund investors that the Master Fund's money had actually been used for the benefit of Gresham until after the commencement of the Division's investigation.

Respondents' Efforts to Hide the Misappropriations

40. The Respondents took several steps to cover up the transfers from the Funds to Gresham. The Funds' "bridge loans" to Gresham were not timely disclosed to the Distressed Fund's investors or TMF Management. During the period when the Funds' assets were being used to finance Gresham, Downey, Geiger and Barbaresi each prepared and/or reviewed periodic (monthly, then quarterly) newsletters to the Distressed Fund's investors in which the nature and amount of the Fund's investments were purportedly described to them. In not one of those newsletters did Downey, Geiger, or Barbaresi disclose the existence of the transfers to Gresham, despite the fact that each of them knew of and had approved the loans. None of the loans to Gresham was properly documented in any of either Fund's books and records. Downey merely directed that they be recorded as entries in VERO Capital's general ledger. At no time did Barbaresi or anyone else prepare any promissory note or other document evidencing Gresham's debt to the Funds as a result of the $4.4 million in ostensible loans that the Funds provided.

41. Cayden first defaulted on interest payments due to the Funds under the Cayden Note in February 2013. Cayden defaulted on the interest payments even though Cayden's original investment strategy, the GNMA trading strategy, had been profitable. When Cayden stopped paying interest, under the terms of the Cayden Note, the Funds could have called the loan and accelerated the due date for the return of the principal (which was December 1, 2013). Neither Geiger, Barbaresi, nor Downey, nor anyone else at VERO Capital, took any action to call the loan on the Funds' behalf.

42. In addition, Downey, who was responsible for valuation of certain of the Funds' assets, did not mark down the value of the Cayden Note on either Fund's balance

sheet after Cayden defaulted on its interest payments on the Note. This stood in sharp contrast to his decision to mark down the Envo and Tallas Notes in April 2012. Nor did Downey or anyone else at VERO Capital inform U.S. Bank, the Funds' administrator, that Cayden had defaulted on the Cayden Note until December 2013. As a result of Downey's failure to mark down the value of the Cayden Note, the Funds' assets under management were overstated and their losses understated in quarterly investor statements issued in March 2013 and later. In addition, the management fees assessed to the Distressed Fund's investors were based on an inflated Net Asset Valuation, and thus investors were overcharged.

Geiger, Barbaresi, and Downey Benefit from the Misappropriations

43. Geiger, Barbaresi, and Downey directly benefited from the misappropriations from the Funds. For example, from August to October 2013, when the $800,000 from the Master Fund account was the primary source of money for VERO Capital, Downey paid himself more than $125,000 in purported salary and expenses, purportedly earned as a result of work he had performed for Gresham. Downey also directed $48,000 to Geiger or to pay bills on his behalf, and wired another $40,000 to Barbaresi, all also representing purported compensation or reimbursement due from Gresham.

44. In addition, Gresham is a wholly-owned subsidiary of VERO Capital, which is co-owned by Geiger, Barbaresi, and Downey, among others. The misappropriations from the Funds to finance Gresham's ongoing development and operations in 2012 and 2013 thus inured to the benefit of Geiger, Barbaresi, and Downey, as they stood to gain from any profits that Gresham ultimately generated.

VERO Capital Failed to Comply with the Custody Rule in 2012 and 2013

45. As investment adviser to the Funds, VERO Capital held custody of Fund assets because it was authorized or permitted to withdraw money from the Master Fund's custodial account. Because VERO Capital had custody of client assets, Advisers Act Rule 206(4)-2 required VERO Capital to, among other things, provide notice to investors in the Funds upon opening the account with U.S. Bank on their behalf, establish a reasonable belief upon due inquiry that U.S. Bank was delivering account statements to investors in the Fund at least quarterly, and undergo an annual surprise examination by an independent public accountant. Alternatively, VERO Capital could have had the Funds audited annually by an independent public accountant that was registered with and subject to regular inspection by the Public Company Accounting Oversight Board and distribute audited financial statements prepared in accordance with Generally Accepted Accounting Principles to the investors in the Funds within 120 days of the Funds fiscal year end. VERO Capital did neither in 2012 and 2013.

E. VIOLATIONS

46. As a result of the conduct described above, VERO Capital, Geiger, Barbaresi, and Downey willfully violated Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder, which prohibit fraudulent conduct by an investment adviser.

47. As a result of the conduct described above, VERO Capital willfully violated Section 206(3) of the Advisers Act, which prohibits an investment adviser from, directly or indirectly, "acting as principal for his own account, knowingly to sell any security or to purchase any security from a client . . . without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction."

48. As a result of the conduct described above, VERO Capital willfully violated Section 206(4) of the Advisers Act and Rule 206(4)-2 promulgated thereunder, which requires that an investment adviser maintain each client's funds in bank accounts containing only those client funds, notify its clients about the place and manner in which their funds are maintained, and have client funds and securities verified by an independent public accountant at least once a year without prior notice to the investment adviser.

49. As a result of the conduct described above, VERO Capital willfully violated, and Geiger, Barbaresi, and Downey willfully aided and abetted and caused VERO Capital's violations of Sections 206(1), 206(2), and 206(4) of the Advisers Act and Rule 206(4)-8 promulgated thereunder, which prohibit fraudulent conduct by an investment adviser, Section 206(3) of the Advisers Act, which prohibits an investment adviser from, directly or indirectly, "acting as principal for his own account, knowingly to sell any security or to purchase any security from a client . . . without disclosing to such client in writing before the completion of such transaction the capacity in which he is acting and obtaining the consent of the client to such transaction," and Rule 206(4)-2 promulgated thereunder, which requires that an investment adviser maintain each client's funds in bank accounts containing only those client funds, notify its clients about the place and manner in which their funds are maintained, and have client funds and securities verified by an independent public accountant at least once a year without prior notice to the investment adviser.

III.

In view of the allegations made by the Division of Enforcement, the Commission deems it necessary and appropriate in the public interest that public administrative and cease-and-desist proceedings be instituted to determine:

A. Whether the allegations set forth in Section II hereof are true and, in connection therewith, to afford Respondents an opportunity to establish any defenses to such allegations;

B. What, if any, remedial action is appropriate in the public interest against Vero Capital pursuant to Section 203(e) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act;

C. What, if any, remedial action is appropriate in the public interest against Geiger, Barbaresi, and Downey pursuant to Section 203(f) of the Advisers Act including, but not limited to, disgorgement and civil penalties pursuant to Section 203 of the Advisers Act;

D. What, if any, remedial action is appropriate in the public interest against Respondents pursuant to Section 9(b) of the Investment Company Act including, but not limited to, disgorgement and civil penalties pursuant to Section 9 of the Investment Company Act;

E. What, if any, remedial action is appropriate in the public interest against Downey pursuant to Rule 102(e)(1) of the Rules of Practice; and

F. Whether, pursuant to Section 203(k) of the Advisers Act, Respondents should be ordered to cease and desist from committing or causing violations of and any future violations of Sections 206(1), 206(2), 206(3), and 206(4) of the Advisers Act and Rules 206(4)-8 and 206(4)-2 promulgated thereunder, whether Respondents should be ordered to pay a civil penalty pursuant to Section 203(i) of the Advisers Act, and whether Respondents should be ordered to pay disgorgement pursuant to Section 203 of the Advisers Act.

IV.

IT IS ORDERED that a public hearing for the purpose of taking evidence on the questions set forth in Section III hereof shall be convened not earlier than 30 days and not later than 60 days from service of this Order at a time and place to be fixed, and before an Administrative Law Judge to be designated by further order as provided by Rule 110 of the Commission's Rules of Practice, 17 C.F.R. § 201.110.

IT IS FURTHER ORDERED that Respondents shall file an Answer to the allegations contained in this Order within twenty (20) days after service of this Order, as provided by Rule 220 of the Commission's Rules of Practice, 17 C.F.R. § 201.220.

If any Respondent fails to file the directed answer, or fails to appear at a hearing after being duly notified, the Respondent may be deemed in default and the proceedings may be determined against him upon consideration of this Order, the allegations of which may be deemed to be true as provided by Rules 155(a), 220(f), 221(f) and 310 of the Commission's Rules of Practice, 17 C.F.R. §§ 201.155(a), 201.220(f), 201.221(f) and 201.310.

This Order shall be served forthwith upon Respondents personally or by certified mail.

IT IS FURTHER ORDERED that the Administrative Law Judge shall issue an initial decision no later than 300 days from the date of service of this Order, pursuant to Rule 360(a)(2) of the Commission's Rules of Practice.

In the absence of an appropriate waiver, no officer or employee of the Commission engaged in the performance of investigative or prosecuting functions in this or any factually related proceeding will be permitted to participate or advise in the decision of this matter, except as witness or counsel in proceedings held pursuant to notice. Since this proceeding is not "rule making" within the meaning of Section 551 of the Administrative Procedure Act, it is not deemed subject to the provisions of Section 553 delaying the effective date of any final Commission action.

By the Commission.

Brent J. Fields
Secretary

UNITED STATES OF AMERICA

Before the
Securities and Exchange Commission
December 30, 2014

Securities Exchange Act of 1934
Release No. 73953 / December 30, 2014

In the Matter of **NASDAQ OMX PHLX LLC**	**Order Granting Petition for Review and Scheduling Filing of Statements**

Pursuant to Rule 431[1] of the Rules of Practice, the petition of NASDAQ OMX PHLX LLC for review of the staff's action in disapproving by delegated authority File No. SR-Phlx-2013-113[2] is granted.

It is ORDERED, pursuant to Rule 431 that any party or other person may file a statement in support of or in opposition to the action made by delegated authority on or before January 20, 2015, and

The order disapproving such proposed rule change shall remain in effect.

By the Commission.

Brent J. Fields
Secretary

1 17 CFR 201.431.

2 See Securities Exchange Act Release No. 72633 (July 16, 2014), 79 FR 42578 (July 22, 2014).

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-73975; File Nos. SR-FICC-2014-810; SR-NSCC-2014-811; SR-DTC-2014-812)

December 31, 2014

Self-Regulatory Organizations; Fixed Income Clearing Corporation; National Securities Clearing Corporation; The Depository Trust Company; Notice of Extension of Review Period of Advance Notices, as Amended, to Amend and Restate the Third Amended and Restated Shareholders Agreement, Dated as of December 7, 2005

On November 5, 2014, Fixed Income Clearing Corporation ("FICC"), National Securities Clearing Corporation ("NSCC"), and The Depository Trust Company ("DTC," together with FICC and NSCC, "Operating Subsidiaries") filed with the Securities and Exchange Commission ("Commission") advance notices SR-FICC-2014-810, SR-NSCC-2014-811 and SR-DTC-2014-812 ("Advance Notices"), pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act")[1] and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 ("Exchange Act").[2] On November 17, 2014, the Operating Subsidiaries each filed Amendments No. 1 to the Advance Notices.[3] On November 17, 2014, FICC withdrew Amendment No. 1 and filed Amendment No. 2 to advance notice SR-FICC-2014-810.[4] The Advance Notices were published for comment in the Federal Register on

1 12 U.S.C. 5465(e)(1).

2 17 CFR 240.19b-4(n)(1)(i).

3 NSCC and DTC filed Amendment Nos. 1 to provide additional description of the changes proposed in advance notices SR-NSCC-2014-811 and SR-DTC-2014-812, respectively.

4 FICC withdrew Amendment No. 1 to advance notice SR-FICC-2014-810 due to an error in filing the amendment. FICC filed Amendment No. 2 to advance notice SR-FICC-2014-810 in order to provide additional description of the changes proposed in the advance notice.

December 11, 2014.[5] As of December 31, 2014, the Commission had not received any comment letters on the proposal contained in the Advance Notices.

Section 806(e)(1)(G) of the Clearing Supervision Act provides that the Operating Subsidiaries may implement the changes proposed in the Advance Notices if they have not received an objection to the proposed changes within 60 days of the later of (i) the date that the Commission receives the Advance Notices or (ii) the date that any additional information requested by the Commission is received,[6] unless extended as described below.

Pursuant to Section 806(e)(1)(H) of the Clearing Supervision Act, the Commission may extend the review period of an advance notice for an additional 60 days, if the changes proposed in the advance notice raise novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension.[7]

Here, as the Commission has not requested any additional information, the date that is 60 days after the Operating Subsidiaries filed the Advance Notices with the Commission is January 4, 2015. However, the Commission finds it appropriate to extend the review period of the Advance Notices, as amended, for an additional 60 days under Section 806(e)(1)(H) of the Clearing Supervision Act.[8] The Commission finds the Advance Notices, as amended, are both novel and complex because the material aspects of the proposed amendments to the Shareholders

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5 See Release No. 34-73755 (Dec. 5, 2014), 79 FR 73665 (Dec. 11, 2014).

6 See 12 U.S.C. 5465(e)(1)(G).

7 See 12 U.S.C. 5465(e)(1)(H).

8 Id.

Agreement are substantial, a first for the Clearing Agencies, and are interrelated with other regulatory aspects of the Clearing Agencies.

Accordingly, the Commission, pursuant to 806(e)(1)(H) of the Clearing Supervision Act,[9] extends the review period for an additional 60 days so that the Commission shall have until March 5, 2015 to issue an objection or non-objection to the Advance Notices, as amended (File Nos. SR-FICC-2014-810, SR-NSCC-2014-811, and SR-DTC-2014-812).

By the Commission.

Brent J. Fields
Secretary

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9 Id.